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Supreme Court of the United States

OCTOBER TERM, 1956

No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES,
PETITIONERS,

vs.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 16, 1956
CERTIORARI GRANTED OCTOBER 8, 1956

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA, ATLANTA DIVISION

No. 5001 Civil Action

GORDON P. HAYNES AND ESSIE M. HAYNES, Plaintiffs,

vs.

THE UNITED STATES OF AMERICA, Defendant.

COMPLAINT—Filed October 4, 1954

1.

Jurisdiction is invoked pursuant to the provisions of Title 28, Section 1346 (a) (1) (i) (ii), United States Code, to recover income tax erroneously assessed against and illegally collected from plaintiffs by defendant, the total amount sought to be recovered herein not exceeding $10,000, and the Collector of Internal Revenue who collected same now being dead and no longer in office.

2.

During 1949 plaintiffs paid to Marion H. Allen, Collector of Internal Revnue for Georgia, by means of withholding tax, the sum of Three Hundred Eighteen and 44/100 Dollars ($318.44), representing income tax on the sum of $2100.00 paid to plaintiff Gordon P. Haynes as sickness disability benefits for the year 1949 by the Southern Bell Telephone and Telegraph Company. The said Marion H. Allen, Collector of Internal Revenue, thereafter died on or about September 10, 1952, and is no longer in office.

[fol. 2]

3

On March 3, 1953, plaintiffs filed with the Director of Internal Revenue for Georgia their claim for the refund of said amount erroneously assessed and illegally exacted from them by defendant, specifying therein as grounds for recovery that the sum of $2100.00 paid to plaintiff Gordon P. Haynes by the Southern Bell Telephone and Telegraph

Company was sickness benefits, and as such was exempt from taxation under Title 26, Section 22 (b) (5), of the United States Code.

4.

For the reasons set forth in said claim for refund and hereinbefore specified, the above mentioned taxes were erroneously assessed against and illegally collected from plaintiffs (they being husband and wife and filing a joint return of income for tax purposes for 1949).

5.

Plaintiffs were notified on June 2, 1954, that their claim for a refund of said amount of $318.44 had been disallowed in full by direction of the Commissioner; and plaintiffs now file this their suit for the recovery of said sum within two years after the receipt of said notice.

Wherefore, plaintiffs demand judgment against defendant for the sum of $318.44 with interest thereon at 6% per annum, as provided by law.

/s/ John H. Hudson, /s/ William R. Hudson, Attorneys for Plaintiffs, 521 Connally Building, Atlanta 3, Georgia

Summons and Marshal's return omitted.

Filed October 5, 1954.

[fol. 3] IN UNITED STATES DISTRICT COURT

ANSWER—Filed December 6, 1954

The defendant, United States Attorney, by its attorney, James W. Dorsey, United States Attorney for the Northern District of Georgia, answering herein, the allegations in plaintiffs' complaint:

First

Denies the allegations of such complaint not admitted, qualified or otherwise specifically referred to below;

Second

1. Denies the allegations in paragraph 1, except that it is admitted that jurisdiction is invoked pursuant to the provisions of Title 28, United States Code, Section 1346 (a) (1), as amended, to recover income tax assessed against and collected from plaintiffs by defendant, that the total amount sought to be recovered therein does not exceed $10,000, and that the Collector of Internal Revenue who collected the tax is no longer in office.

2. Denies the allegations in the first sentence of paragraph 2 and admits the allegations in the second sentence of paragraph 2, except that it is admitted that plaintiffs paid $723.84 in income tax liability for 1949.

3. Denies the allegations in paragraph 3, except that it is admitted that on March 3, 1953, plaintiffs filed with the Director of Internal Revenue for Georgia their claim for refund of 1949 income taxes in the amount of $318.44.

4. Denies the allegations in paragraph 4, except that it is admitted that plaintiffs, as husband and wife, filed a joint income tax return for 1949.

5. Admits the allegations in paragraph 5.

Wherefore, the defendant, United States of Amer-
[fol. 4] ica, having fully answered plaintiffs' complaint, prays that they take nothing in this suit, that their complaint be dismissed, and that defendant be allowed its costs herein.

/s/ James W. Dorsey, United States Attorney, Attorney for Defendant.
/s/ Slaton Clemmons, Assistant U. S. Attorney
/s/ Charles D. Read, Jr., Assistant U. S. Attorney.

Certificate of service ommitted.

Filed December 6, 1954.,

[fol. 5] IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

Civil Action No. 5001

GORDON P. HAYNES, ESSIE M. HAYNES

v.

THE UNITED STATES OF AMERICA

Transcript of Trial

Before: Honorable William Boyd Sloan, Judge, January 6, 1955.

APPEARANCES

For the plaintiffs: John R. Hudson, Attorney, Wm. R. Hudson, Attorney, 98 Alabama Street, S. W., Atlanta 3, Georgia.

For the Government: Harlan Pomeroy, Special Assistant to the Attorney General, Tax Division, Department of Justice, Washington 25, D. C., Slaton Clemmons, Assistant United States Attorney, Charles D. Read, Jr., Assistant United States Attorney, Atlanta 3, Georgia.

(The above named case having come on for hearing before [fol. 6] the Court without a jury, witnesses sworn rule not invoked, and the following proceedings were had.)

Mr. John H. Hudson: We can very greatly shorten this case. There are some documents, Your Honor, a goodly number of documents here. As the Court probably knows already, this claim is based on a contention that the benefits paid under what the plaintiff will refer to as Exhibit A, which is the printed form of the plan—certain portions of that, may it please the Court, we think are relevant and pertinent, but Mr. Pomeroy has said that he did not, that he would not object to the whole thing, he wanted the whole plan to go in, and I can readily appreciate that. Now, he has —may I have that certificate?

Mr. Pomeroy: May it please the Court, the Government has a series of documents that it does want to introduce,

but it wants to have them properly identified by the witnesses and authenticated before it introduces them. I think we might wait until the Government presents its case.

OFFER IN EVIDENCE

Mr. Hudson: I was under the impression, may it please Your Honor, that where counsel make agreements and stipulations as to certain documents, that he doesn't need testimony to identify them, but that's all right. I was fixing to tender this on behalf on the plaintiff now and have it identified as Plaintiff's Exhibit A.

The Court: That is all right. Present it to the Clerk. Have it identified.

The Clerk: Plaintiffs Exhibit #1 being the Plan for Employees Pensions, Disability Benefits and Death [fol. 7] Benefits of the Southern Bell Telephone & Telegraph Company.

(Above booklet marked for identification only as Plaintiffs' Exhibit #1.)

The Court: I understand you offer that in evidence at this time?

Mr. Hudson: That is correct, Your Honor.

The Court: Is there objection to this plan?

Mr. Pomeroy: No, Your Honor. We have no objection.

The Court: It is in evidence.

(Plaintiffs' Exhibit #1 received in evidence.)

The Court: Now, is it stipulated that the sum sued for here was paid to the taxpayer, Gordon Haynes, by reason of illness under that plan? Is that stipulated?

STIPULATION OF COUNSEL

Mr. Hudson: Your Honor, the stipulation, I believe, is like this, if Your Honor please: The Telephone Company withheld the amount of Three Hundred Eighteen dollars forty-four cents ($318.44) of the money which was paid to Mr. Haynes, the plaintiff, and turned it in as taxable income for the year 1949. That is stipulated, may it please the Court.

It is further stipulated that this is merely an action on

the part of one of two plaintiffs for the recovery of this sum of money, three hundred eighteen dollars forty-four cents, and that Mrs. Essie M. Haynes is a mere nominal party; that she is not interested insofar as this suit is concerned, in the three hundred eighteen dollars forty-four cents.

[fol. 8] The Court: Yes, sir, I understand that, Mr. Hudson. I understand that the Telephone Company did retain the, or deduct from these payments the income tax, and did pay it to the Government, but it is your contention that that was improperly done, or erroneously done because these were sick benefits?

Mr. Hudson: That is correct, Your Honor.

The Court: Now, is there any stipulation in the record that the sums paid to Mr. Haynes were sick benefits under the plan?

Mr. Pomeroy: May it please the Court, the Government is prepared to agree that some Twenty-one hundred dollars was paid to the taxpayer in this case pursuant to the plan.

The Court: And paid to him and received by him as sick benefits?

Mr. Pomeroy: Yes, sir.

The Court: Under the plan?

Mr. Pomeroy: Sickness disability benefits under that plan.

The Court: Sickness disability benefits under that plan. All right. That is stipulated and let the record show that it is so stipulated.

Mr. Hudson: Now, Your Honor, there is a question in my mind as to whether there is any necessity for putting the plaintiff on the witness stand under those stipulations. Perhaps I had better do it, make him available to the Court and to counsel for the Government merely to identify him with this cause of action.

[fol. 9] The Court: Well, whatever you wish to do.

MR. GORDON P. HAYNES having been sworn, testified as follows:

Direct Examination.

By Mr. Hudson:

Q. Will you state your name, please, sir?

A. Gordon P. Haynes.

Q. Mr. Haynes, are you one of the plaintiffs in this action here?

A. Yes, sir, I am.

Q. This suit for a claim of a refund of money you paid to the, or was paid to the Treasury Department of the United States on your behalf?

A. Yes, sir. That is correct.

Q. Were you employed by the Southern Bell Telephone Company—Telephone and Telegraph Company in the year 1949?

A. Yes, sir, that is correct, I was.

Q. Tell the Court, please, sir, how long you had been employed by this Southern Bell Telephone & Telegraph Company, the first part of the year 1949?

A. How long——

Q. How many years were you employed by the Southern Bell Telephone & Telegraph Company prior to the year 1949?

A. Since 1921, sir.

Q. Now, you are the Gordon P. Haynes, plaintiff in [fol. 10] this case, on whose behalf the Southern Bell Telephone & Telegraph Company turned over to the Treasury Department this sum of money which you claim was not taxable?

A. I am, sir.

Q. How did this disability arise, if there was any disability, Mr. Haynes?

A. This—you mean the nature of the illness, sir?

Q. Yes, sir.

A. It was recurring spells of what is known as amnesia, according to the doctor, and dizzyness caused by quite a bit of pain in my foot, brought about by a previous accident a few years before that time.

Q. Two years before 1949?

A. About the exact——

Q. Just what is your best recollection as to when the accident occurred, and also the date when this alleged disability occurred?

A. The original accident occurred in 1946, when I had an accident.

Q. Well, tell the Court please——

The Court: As I understand it, there is no issue with respect to the illness in any way, is there?

Mr. Pomeroy: That is correct, Your Honor. We have no dispute at all.

The Court: All right. It is stipulated that these sums were paid to him as a result of illness under this plan.

[fol. 11] Mr. Hudson: During the year 1949?

The Court: That is right.

Mr. Pomeroy: I would like to make one reservation. We say these amounts were paid under the plan. We do not admit they were necessarily sick disability benefits. As a matter of fact, they were simply so entitled under the plan. We reserve, of course, the right to assert they are a continuation of compensation, as pointed out at the very beginning.

The Court: Yes. There is no dispute that the man was ill, and that they were paid to him as——

Mr. Pomeroy: That is correct, Your Honor.

The Court: —under the plan. All right. I understand your stipulation.

Q. Now,——

Mr. Hudson: May it please the Court, I think we have agreed on the fact that on March 3, 1953, the plaintiff filed with the Director of Internal Revenue for Georgia, their claim for a refund.

The Court: That is admitted in the pleadings.

Mr. Hudson: Is that right?

Mr. Pomeroy: Yes. It is all admitted in the pleadings.

Mr. Hudson: You may take the witness.

Mr. Pomeroy: I have just two questions I would like to ask you, Mr. Haynes.

[fol. 12] Cross-examination.

By Mr. Pomeroy:

Q. The first question is: Do you recall your weekly rate of pay in 1949?

A. I am sorry, sir, I do not recall it.

Q. All right. Do you recall how often you were paid in 1949?

A. Yes, sir, bi-weekly, every other week.

Q. And were you paid by check or in cash?

A. By check.

Mr. Pomeroy: I have no further questions.

Redirect examination.

By Mr. Hudson:

Q. Were you working, as we laymen call it, for the Southern Bell Telephone & Telegraph Company during the time that this, these sums of money were paid to you?

A. No, sir, I was not performing any work.

Q. For the Company?

A. That is right.

Mr. Pomeroy: No further questions.

The Court: You may go down.

Mr. Hudson: Come away.

(Whereupon the witness was excused from the stand.)

The Court: Anything further from the plaintiff?

[fol. 13] Mr. Hudson: We rest for the present, Your Honor.

The Court: All right.

Mr. Hudson: I believe the plan is offered in evidence.

The Court: Proceed for the Government.

MR. R. V. DAVIS, having been sworn, testified as follows:

Direct examination.

By Mr. Pomeroy:

Q. Will you state your name, address and occupation, please?

A. R. V. Davis. Office is in the Hurt Building, and I am General Supervisor of Employee Benefits of the Southern Bell Telephone Company.

Q. And your office is here in Atlanta?

A. In Atlanta, yes, sir.

Q. How long have you been Secretary of the Employees Benefit Committee?

A. Since December, 1946.

Q. And what was your occupation prior to that time?

A. I was General Personnel Supervisor.

Q. And how long have you been with the Telephone Company?

A. Between thirty-eight and thirty-nine years.

Q. Can you describe very briefly the nature of your [fol. 14] functions as Secretary of the Employees Benefit Committee?

A. Well, I am responsible for the administration, the office administration and general supervision of the operation of the Plan of Employees Pensions, Disability Benefits and Death Benefits.

Q. Can you state how many members there are of the Employees Benefit Committee?

A. Five regular members and two alternates.

Q. And who appoints these members?

A. The Board of Directors of the Company.

Q. Will you state to whom the Employees Benefit Committee is responsible?

A. They are responsible primarily, to the Board, and in certain specified areas to the President of the Company.

Q. Can you state again, briefly, the names and occupations of the various Committee Members? Now, I would like to relate this to 1944, if possible, if you can recall the members at that time.

A. You have a copy of the Annual Report, or the Annual Report of the Committee. If I could refer to that, please?

Q. Yes, sir.

Mr. Pomeroy: I will have this marked for identification purposes as Government Exhibit #1.

The Clerk: U. S. Exhibit #1 is the Southern Bell—Southern Telephone News, April 1, 1950.

[fol. 15] (Above marked for identification only as U. S. Exhibit #1.)

Q. Mr. Davis, I hand you what has been marked for identification purposes as Government Exhibit #1, and ask you to identify it, please?

A. This is a copy of the Southern Telephone News of April 1, 1950.

Q. And is that published by the Telephone Company?

A. Published by the Telephone Company, yes, sir.

Q. And I invite your attention to Page 18 of Exhibit #1; and ask if you will identify the subject matter of Page 18?

A. On Page 18 is shown a report of the Employees Benefit Committee to the employees of the Southern Bell Telephone Company, as provided for in the plan.

Q. Now, with Page 18 of Exhibit #1 before you, will you answer then the question—who were the Committee Members in 1949?

A. The Chairman of the Committee was Mr. G. D. Garner—do you want——

Q. Will you state his occupation with the Company?

A. He was Vice-President, Personnel. He has since retired. Mr. J. A. Gantt, who at the time was General Traffic Manager of the Company. Mr. F. M. Malone, who at the time was General Commercial Manager. Mr. H. R. Stone, who at the time and is now Comptroller of the Company. He is now Vice-President—I am not certain whether he was [fol. 16] Vice-President at that time or not, but he was Comptroller. Mr. W. A. Thompson, who at the time was General Plant Manager. They are the five members.

Q. Then were these Committee Members at that time, then, heads of the various departments of the Company?

A. Yes, they were.

Q. Approximately how much time in a given week do the Committee Members spend on Committee business?

A. It would be difficult to express that in terms of a week. We have a monthly meeting of the full Committee, Mr.

Pomeroy, which takes up one morning, from nine thirty until about twelve thirty. That is three hours. And then there is incidental time between the regular meetings, either with special meetings or conferences on benefit matters.

Q. Would it be a correct statement to say the Committee members do not spend in excess of three hours a week on Committee affairs?

A. I think that would be a reasonable statement, yes, sir.

Q. And it is a correct statement that the majority of their time is devoted to other company or corporate affairs?

A. That is correct, yes, sir.

Mr. Pomeroy: At this time I would like to introduce into evidence Page 18 of Government Exhibit #1.

The Court: Is there objection?

[fol. 17] Mr. Hudson: There is no objection, may it please Your Honor, to the Page 18—that is the one you showed me there a moment ago?

Mr. Pomeroy: That is correct.

Mr. Hudson: But may it please the Court, in the interest of time, and in the interest of cost in the event there should be an appeal, I don't think that the magazine itself would be admissible.

Mr. Pomeroy: Well, we agreed to that and I have just mentioned that I would like to introduce Page 18. I propose to rip out Page 18, if there is no objection, and introduce only Page 18.

Mr. Hudson: No. That is one part of the page there. Something on the back.

Mr. Pomeroy: Well, there is, yes, but——

Mr. Hudson: But you are not tendering what is on the reverse side of the page.

The Court: Well, there is only one side of the page that is numbered 18.

Mr. Pomeroy: Yes, sir, that is correct.

The Court: That is the side you are introducing?

Mr. Pomeroy: Yes, sir.

Mr. Hudson: There is no objection to that.

The Court: It is admitted in evidence.

The Clerk: That becomes U. S. Exhibit #1.

(Page 18 referred to above received in evidence as U. S. Exhibit #1.)

[fol. 18] Q. Let me ask you, Mr. Davis, again briefly, what does the Committee do?

A. The Committee is responsible for the entire administration of the plan, and they approve, ratify the actions of the State Benefit Committees, and of myself and my office.

Q. Now, for the purpose of clarification can you describe briefly the organization of these State Benefit Committees and their relationship to the Committee of which you are Secretary?

A. Yes, sir. We operate in nine states, and in each of those states there is a State Benefit Committee comprised of six members who are appointed with the sanction of the Board of Directors, by the Employees Benefit Committee, which is commonly termed the "General Committee."

Q. That would be the Committee of which you are Secretary?

A. That is correct, yes, sir.

Q. And are the Committee members of these various State Committees persons similar in nature to the Committee members of the Parent Committee?

A. That is correct. They are the State Department Heads in their respective states.

Q. They are the heads of the various operating departments of the company in that state, is that correct?

A. That is correct, yes, sir. Now, that is the fact as to their positions in the present committees, though the responsibility of the General Committee for appointing [fol. 19] members of the State Committees is not limited to any particular title or job.

Q. Are sickness disability benefits ever paid before approval by the Committee? When I speak of the "Committee," I speak of the Committee of which you are Secretary.

A. Yes. The Committee of which I am Secretary, the Employees Benefit Committee has, by authority of the Board, given to the State Benefit Committees, and through them to the Secretary of the State Benefit Committee, the authority to pay sickness disability benefits prior to ratification by the General Committee, but with the limitation that the action of the State Committee is not final until it is ratified by the General Committee.

Q. When you say——

A. That, incidentally, is done in the interest of time, to avoid the necessity of the employee being without his sickness pay,——

Q. Now, when you say——

A. —until they come in.

Q. —The approval is subject, is not final and is subject to approval by the Parent Committee——

A. Subject to ratification.

Q. What would happen if the State Committee did authorize payments and the Parent Committee then did not approve such payments?

A. The payments would certainly stop, and might be recovered.

[fol. 20] Q. How would they be recovered? Do you know? Has this ever happened?

A. No. The recovery has not occurred, no. There have been cases in which the General Committee did not ratify the benefits, and the benefits then were stopped.

Q. Let me ask you, Mr. Davis, when approval is given by the Committee of which you are Secretary, is it given for the full amount of benefits to which the employee is entitled under the plan?

A. It is. Yes, it is. The authority, the approval is given and is ratified for the period during which the employee will be entitled to benefits, unless there is prior recovery and the authorization specifies that the benefits are approved during disability not to extend beyond a certain specified date; as covered in the plan.

Q. And by "prior recovery" you mean prior returns because of the te mination of illness?

A. Yes. Prior recovery, or death, or some circumstances which would terminate the benefits otherwise; yes.

Q. Have persons other than employees of the company ever been covered under the plan?

A. No, sir.

Q. Do the employees make contributions for the benefits received under the plan?

A. No, sir.

Mr. Hudson: Now, may it please the Court, just as the question was framed, put and answered, we object to that [fol. 21] as a conclusion, in the first place, on the part of the witness; in the second place, it is an opinion. Now——

The Court: What do you say to that? I understand your objection, you needn't argue your objection. What do you say about that?

Mr. Pomeroy: Well, I say it is simply, it seems to me, a fact, whether contributions are or are not made, and the witness, I believe——

The Court: Well, it is Mr. Hudson's position, possibly, that the contribution is in services, and that this is a part of a general plan,——

Mr. Pomeroy: Yes, sir.

The Court: —so it, you can ask the witness, and I assume that it what you are undertaking to prove, whether there is any contribution that is identified as a contribution for that particular service.

Mr. Pomeroy: What I had in mind, Your Honor, is that if there is some ambiguity in either the question or the answer, I thought it could be brought out on cross examination. I will be glad to rephrase the question if it is misleading in any way.

The Court: I believe if you would rephrase the question it would probably clarify it.

Mr. Pomeroy: All right. I will.

Q. Let me ask you, Mr. Davis, did the employees make any contributions in the way of cash or other assets of value for the benefits received under the plan?

A. No, sir, not to my knowledge.

[fol. 22] Q. Are employees of the company ever given their regular salary during the first week of absence on account of sickness?

A. Yes. Under certain circumstances their pay is continued on a departmental basis, not under the plan, during the first seven days of absence due to sickness.

Q. Do employees who have worked for less than two years with the company ever receive benefits under the plan?

A. Not under the plan.

Q. But they do receive benefits, is that correct?

A. It is possible that they might in unusual circumstances be paid sums, and what we would term "other benefits" not under the plan.

Q. Would the Committee approve such "other benefits?"

A. That's right. They would have to.

Q. And are there other benefits authorized by the Committee that are paid in excess of those provided for in the plan?

A. There could be, yes, sir.

Q. Now, those are approved by the Committee, is that correct?

A. That is correct, yes, sir.

Q. Are these supplemental benefits sometimes approved in needy cases? Is that——

A. That would generally be the type of case in which [fol. 23] something other, something outside over and above the plan would be paid, yes, sir.

Q. Do you recall a situation where a sick employee failed to follow the Committee's advice and was deprived of benefits under the plan for that reason?

A. I do not recall a case in which the employee benefits were denied due to failure to follow medical advice. There have been cases which I recall in which the employee failed to do other things. For instance, have an examination that the Committee asked for, or went away from home without getting permission, and which benefits have been stopped.

Q. Does the company maintain a fund from which the sickness disability benefit payments are made?

A. No, sir. They are paid as an operating expense, and classified to a particular classification as set out in the accounting instructions.

Q. Is it true that at one time there was a fund?

A. That is correct.

Q. And when did that fund exist, approximately?

A. It existed from 1913 until, I believe, 1928 or thereabouts.

Q. Is there an independent trust or association which administers the sickness disability benefits provisions of the plan?

A. There is no independent trust. I am not sure what you would mean.

Q. Well, is there an association——

[fol. 24] A. By an "association"—there is a benefit committee which——

Q. I mean, not connected with the company?

A. Other than the benefit committee there is none.

Q. Do you know if the company sets up a book reserve for sickness disability benefit payments?

A. They do not, as far as I know.

Q. Do you know if there is an insurance reserve set up for sickness disability benefit payments?

A. Not as I know of.

Q. Are the sickness disability benefits charged to operating expenses of the company?

A. Ultimately, yes, sir. They are identified as sickness disability benefits on the books, and are a charge to operating expenses, yes, sir.

Q. Now, are all employes of the company, except those who have worked for less than two years, covered by the plan?

A. By the sickness benefit provisions of the plan, they are, yes, sir.

Q. And does this include all executives up to and including the President of the company?

A. Yes, sir.

Q. Were sickness disability benefits provided for in the plan in 1913 when it was adopted?

A. Yes, they were.

Q. Let me ask you, Mr. Davis, if an employee re- [fol. 25] ceives sickness disability benefits payments under the plan, and then returns to work and within two weeks of his return to work he becomes sick again, let's say in the course of the day, before the day is completed——

A. Umm humm.

Q. —does the employee receive any sickness disability benefit for that day when he does not work the entire day?

A. Will you repeat that, please?

Q. Will the reporter read back the question, please? (Whereupon the question is read back.)

A. No, sir. He would be paid on the payroll for that part of the day, if he had reported and started to work on that day.

Q. When an employee retires and is entitled to a pension under the plan, is such a pension paid from a trust fund?

A. If it is a service pension, yes. If it is a disability pension it is paid and charged to operating expenses.

Q. And are there trustees of this pension fund?

A. The pension trust fund, which is set aside for the payment of service pensions only, is trusteed by the Bankers Trust Company, yes sir.

The Court: What is the relevance of that line of examination in this case?

Mr. Pomeroy: If it please the Court, I am trying to show that funds have been set up from which payments have been made for different types of benefits under the [fol. 26] plan, and I am trying to distinguish the particular sickness disability benefits here in controversy from these other payments.

The Court: All right.

Q. Are the company's contributions to the funds, which you have just described, determined on an actuarial basis?

A. Yes, they are.

Q. And does the company make any contributions to a trust, insofar as the sickness disability benefits are concerned?

A. There is no trust as far as the sickness benefits are concerned.

Q. Has the company, insofar as you can recall, ever been sued in court for sickness disability benefits under the plan?

A. Not that I can recall.

Q. Are sickness—I have already asked you that.

A. Claims have been made but I don't recall any case in which there has actually been a suit in court.

Q. Approximately what percentage of the payroll comprises sickness disability benefits?

A. I believe about two per cent of the payroll is charged to, or an equivalent of about two per cent of the payroll is charged to benefits. I am sorry I do not have a figure as to the sickness benefits, but I would say between one and two per cent.

Q. And this would include benefits paid under the plan, and benefits in the nature of, paid during the first [fol. 27] week, for example, of an employee's illness, is that correct?

A. Yes.

Q. Umm humm. Did the Committee, does the Committee, or has it ever made loans to employees?

A. Yes.

Mr. Hudson: Your Honor, I would like to interpose an objection to whether the company, through its Committee, ever made loans to employees, as being immaterial and irrelevant, shedding no light——

The Court: I don't see the materiality of it. I may not——

Mr. Pomeroy: May it please the Court, I am trying to give a general picture of what the employees benefit Committee does. That is, that it is responsible in general for the welfare of the employees. It performs other functions in addition to the payment of disability benefits. I am trying to show that it is an executive arm of the corporation which, as we contend, in a case of the sickness disability benefits is continuing regular compensation to employees.

The Court: Well, I don't know just how wide a range the testimony should take in order for you to establish that. Now——

Mr. Pomeroy: I am nearly completed. I would like to say I hoped to make an opening statement, in which I wanted to say that we are trying to make as complete a [Vol. 28] record as possible and give the Court what we consider to be the relevant, material background in this case.

The Court: All right.

Mr. Pomeroy: And I hope to tie all of this together.

The Court: Go ahead.

Mr. Pomeroy: I would like to have marked for identification purposes as Government Exhibit #2, a book called, entitled "Miscellaneous Resolutions, C-6."

The Clerk: You just want #6 benefits?

Mr. Pomeroy: Well, I would like to have the whole book identified as an exhibit, then I propose——

The Clerk: If you are going to introduce just one part——

Mr. Pomeroy: I am not going to introduce the entire book.

The Clerk: U. S. Exhibit #2, Miscellaneous Resolutions.

(Above book marked for identification only as U. S. Exhibit #2.)

Q. Mr. Davis, I am going to hand you what has been marked for identification purposes as Government Exhibit #2, and ask you to identify it, please?

A. This is a loose-leaf book out of my bookcase at the office, in which are filed miscellaneous resolutions [fol. 29] of the Board of Directors which relate to matters under the responsibility of the Employees Benefit Committee.

Q. I would like you to turn to a resolution approved on September 23, 1935, and ask you to identify that, please.

The Court: September 23, when?

Mr. Pomeroy: 1935.

Q. Just briefly state what it is.

A. This is a resolution approved by the Board of Directors on September 23, 1935, authorizing the Employees Benefit Committee where, in their opinion——

Q. Just briefly. I think it does speak for itself.

A. —to bridge, as we term it, the service of an employee whose service was previously broken.

Mr. Pomeroy: The Government would like to introduce at this time, as Government's Exhibit #3, this resolution of September 23, 1935, and we propose, with leave of the Court, to have this resolution, as the two following, typewritten and have typewritten copies substituted in lieu of this cumbersome book, and we believe that is agreeable to the opposing counsel.

Mr. Hudson: We might state—we submit, may it please the Court, that insofar as anything in this particular resolution, that it throws no light on the plan as it was in effect in 1949, and, as it affects this claim, would be immaterial and irrelevant. Now, I haven't had an opportunity to read and digest this resolution, but the part of it that I heard read, it occurs to me, Your Honor, as to be [fol. 30] immaterial and irrelevant, and something that happened before the year 1949, when this claim——

The Court: Well, I will reserve my ruling on the objections, and I will admit the resolution for the present and we will see. I understand it is the position of the Government that this overall plan that the sick, so-called sick benefits, is merely one part of an overall plan in which the employee is generally compensated for his service, and that it is not, therefore, insurance within the meaning of the exception clause of the Act. As it relates to that I will

allow it in evidence so as to show what the overall plan was.

The Clerk: May I mark it, please?

Mr. Pomefoy: Yes. I am going to have two more. Do you want to do it all at one time?

The Clerk: Yes, let me have it. I will mark it.

Mr. Pomeroy: It is our understanding, I believe and the Court I believe has agreed to this, that we are going to substitute typewritten copies.

The Court: It is satisfactory to substitute typewritten copies?

Mr. Hudson: Absolutely. The Court, of course, will note our exception to it.

The Court: Yes, sir, the exception is noted.

The Clerk: This is U. S. Exhibit #3, being Resolution approved September 23, 1935.

(Above Resolution marked for identification only as U. S. Exhibit #3.)

[fol. 31] The Clerk: I believe that is the one that is admitted?

The Court: It is admitted subject to the objection that has been made. Objection will be ruled on.

(U. S. Exhibit #3 received in evidence.)

The Clerk: No. 4 is an excerpt from the Minutes of Meeting of Board, June 23, 1925?

Mr. Pomeroy: Yes, that is correct, June 23, 1935.

The Court: That 1935?

Mr. Pomeroy: 1925, Your Honor.

The Court: 1925.

The Clerk: That is U. S. Exhibit #4.

(Above resolution marked for identification only as U. S. Exhibit #4.)

Mr. Hudson: Your Honor, we have not had time to look that over, formulate objections. We'll appreciate the Court giving us time to do that.

The Court: Yes, sir. Right now.

Mr. Pomeroy: I will say I did present this to Mr. Hudson this morning. He has not had time to——

The Court: All right, let Mr. Hudson see it right now, and register any objection he wishes to register.

Mr. Pomeroy: May I continue with my questions on another line and come back to this?

[fol. 32] The Court: No, sir, because he will need to follow you, and he will not have an opportunity. We will just suspend here until he can read this.

The Clerk: U. S. Exhibit #5 being Resolution of the Board of Directors in meeting of April 24, 1944.

(Above Resolution marked for identification only as U. S. Exhibit #5.)

Mr. Hudson: As to——

The Clerk: Call them by exhibit number.

Mr. Hudson: Beg pardon?

The Clerk: The Exhibit Number is on the top.

Mr. Hudson: Exhibit #4, may it please the Court, so far as this resolution relates to temporary relief—that is Paragraph Two of the Resolution—"Temporary relief in cases of sickness or death of employees retired on pension or of accident to them . . ."—insofar as Paragraph Three of this Exhibit relates to loans or salary advances to active employees—plaintiff in the case objects to those two paragraphs as immaterial and irrelevant, and asks the Court to disallow them.

As to the formal parts of the resolution; and as to Paragraph One, with reference to relief measures, plaintiff has no objection. The objection goes to Paragraphs Two and Three of the Exhibit #4.

The Court: All right, the objection will be overruled. It is allowed in evidence.

[fol. 33] (U. S. Exhibit #4 received in evidence.)

Mr. Hudson: As to Exhibit #5, may it please Your Honor, we only object to Paragraph Number Two, "Death Cases. If the employee or pensioner is survived by any of the beneficiaries described in Section Seven . . ."—as being immaterial and irrelevant. The question of relief or compensation in death cases is immaterial and irrelevant to the issues involved in this case.

The Court: Objection overruled. It is admitted in evidence.

(U. S. Exhibit #5 received in evidence.)

The Clerk: That is Exhibits #3, #4, and #5.

Mr. Hudson: Your Honor, the old rule required attorneys to call on the Court to note an exception.

The Court: That is not necessary now. However, the exceptions as to all objections, and rulings that are adverse to the objections made, exceptions are noted and allowed.

Mr. Pomeroy: I have one or two additional questions in relation to Government Exhibit #2 for identification purposes.

Q. I direct your attention to Government Exhibit #4, which is the Resolution of June 23, 1925, and ask you simply if that Resolution is still in effect, and still governs the actions of the Committee?

A. Yes, it is still in effect.

[fol. 34] Q. And one final question. Is an employee of the Telephone Company required to take a physical examination in order to qualify for benefits under the plan when he begins work, or when he first becomes eligible for benefits under the plan?

A. Not necessarily.

Q. Does he have to submit an application for, in order to be covered by the plan, or in order to be eligible to receive benefits under the plan?

A. No.

Mr. Pomeroy: I have no further questions, Your Honor.

Mr. Hudson: Your Honor give me just a minute?

The Court: Yes, sir.

Cross-examination.

By Mr. Hudson:

Q. Mr. Davis, will you explain to the Court what is the difference between a service pension and any other pension that an employee might receive under this plan?

A. Yes, sir. By reference to the plan it will be seen that there are three types of circumstances under which an employee might be eligible to what we term a "Service Pension." An employee who retires at age, a man at age sixty or longer, more, who has, or a woman at age fifty-five or older, who has twenty years or more of service; an em-

ployee who retires, a man at age fifty-five to sixty, a woman fifty to fifty-five, who has twenty-five years of service; or [fol. 35] an employee who retires, regardless of age, after having had thirty years of service, is eligible upon retirement to a service pension.

An employee who does not qualify for service pension but who has fifteen years or more service, and who becomes totally disabled due to sickness or off the job accident, is entitled to what we call a "Disability Pension." The Disability Pension remains in effect during the period of disability. The service pension remains in effect during life.

Mr. Hudson: That is all, Your Honor.

Mr. Pomeroy: I have no further questions, Your Honor.

The Court: You may go down, sir.

(Whereupon the witness was excused from the stand.)

Mr. J. M. Parker, having been sworn, testified as follows:

Direct examination.

By Mr. Pomeroy:

Q. Will you state your name, address and occupation, please?

A. J. M. Parker. I am Division Disbursement Accountant with the Telephone Company here in Atlanta for the State of Georgia. My office is at 800 Peachtree, here in Atlanta.

Q. And do you have responsibility for and familiarity with the payroll records of the Southern Bell Telephone & Telegraph Company for this area?

A. That is correct. My office pays, handles the pay- [fol. 36] rolls for our employees located in Georgia, other than the general office employees.

Q. And are you familiar with the payroll records of the plaintiff in this case, Mr. Haynes, for the year 1949?

A. I am.

Q. Did you bring copies of those payroll records with you?

A. I have. I have a photostatic copy of those payroll records.

Q. Well, I will proceed to ask you some questions and if you need the records, will you so state?

A. I will.

Q. And I will hand them to you. My first questions, my first question is: If an employee is paid during a given pay period, both during sickness and during, both during sickness under the plan and while he is at work—in other words, if, during a given pay period, he is off part of the time, does he receive two checks or one check in payment?

A. The employee would normally receive one check, even though it covered payment for time worked as well as payment for sickness disability benefits. However, the check, the stub that is attached to the check, would reflect the breakdown between the two types of payments that are incorporated in the one check.

Q. Now, if, during a given pay period, an employee was, his regular compensation was paid for the first week while he was sick, and during the second week he re- [fol. 37] ceived payments under the plan, would there be a breakdown similar to the one you just mentioned?

A. Between the first week's pay and the——

Q. The first week's pay while he is absent, and the second week's pay while he is absent?

A. The two would not be distinguished.

Q. I see.

Mr. Pomeroy: I would like to have marked for identification purposes as Government's Exhibit #6, which purports to be the Annual Report of the Southern Bell Telephone & Telegraph Company for 1949.

(Above marked for identification only as U. S. Exhibit #6.)

Q. Mr. Parker, I hand what has been marked for identification purposes as Government Exhibit #6, and ask you to identify it, please?

A. This is the Annual Report for the Year of 1949 of the Southern Bell Telephone & Telegraph Company.

Q. I will ask you, please, to turn to the Profit and Loss Statement contained in the latter portion of the Annual Report.

A. It's on Pages 32 and 33.

Q. And ask you where salaries are shown in the profit and loss statement?

A. Salaries and wages would be shown, depending upon the utilization of those wages, either as a capital asset or an expense item.

[fol. 38] Q. Well, I direct your attention to the heading: "General and Miscellaneous Expenses." Are the salary expenses listed under that heading? Are any salary expenses listed under that heading?

A. Yes. The salary expenses would be listed under that heading.

Q. And is it also true that the sickness disability benefit payments are listed under that heading?

A. As a separate item they are, sir.

Q. And is it, it is also true, is it not, Mr. Parker, that pensions are listed under a separate heading?

A. For service pensions, yes, sir.

Q. Now, I ask you, Mr. Parker, with particular attention to the year 1949, and Mr. Haynes in this case, if you know what his weekly salary rate was?

A. I believe that his weekly salary rate during the period that he was on benefits was seventy-five dollars.

Q. And did he receive his regular salary during the year 1949 from time to time, when he was off of work because sick, and had not qualified for benefits under the plan?

A. You mean were there other periods during the year in which he was off sick? I am not certain, sir.

Q. Well, let me hand you then, I believe these are the photostatic copies. I would like not to introduce these into evidence if it can be avoided, just have the witness testify from them. I would like, while he is looking at those, to introduce in evidence Government Exhibit #6, the Annual Report.

[fol. 39] The Court: Is there objection to the Report of 1949?

Mr. Hudson: I haven't seen the report, may it please the Court. I would like, I would appreciate an opportunity to look that over.

The Court: All right.

Mr. Pomeroy: I will rephrase that question.

Q. In relation to Mr. Haynes, and during the year 1949, were payments made to Mr. Haynes while he was absent from work, but before the one week qualification period of absence had transpired?

A. That is correct. There were other payments.

Q. And is it correct that on the payroll records such payments are listed under sickness payments?

A. That is correct.

Q. And is it true that the sickness disability benefits paid under the plan are also listed under sickness payments on the payroll records?

A. That is correct.

Mr. Pomeroy: I have no further questions.

By the Court:

Q. Now, let's see if I understand that testimony. What two types of payments have you just testified about as having been classified in the payments as sickness benefits?

A. No, sir. I have testified that there were two types of payments which are, on our particular payroll records are reflected under our Code SP, and those include the [fol. 40] payments for this first seven days sickness, cases of that nature as well as cases under the benefit plan. Those are coded on that basis under accounting instructions because we do tax them for withholding tax, or had in the year 1949. Both items were similarly subject to withholding tax under our procedure, and therefore both are similarly coded on our payroll records. They are separately identified on other records as between the payments that apply to sickness disability benefits and those sickness payments that are within the first seven days of sickness and beyond the scope of the plan.

Q. What is the provision of your plan for the first seven days of sickness?

A. The first seven days of sickness are not included in the employees plan for disability and accident, only illnesses running, extending beyond the first seven days of absence are covered by the plan.

Q. Is there any way for you to determine from your records now what portion of this twenty-one hundred dol-

lars that was paid to Mr. Haynes was for the first week of his illness?

A. The twenty-one hundred dollars, that, I am not familiar with the entire amount, but we furnished to Mr. Haynes a statement of the amount that he received during 1949 under the plan, and excluded from that were any payments not under the plan the first seven days, so it is my——

Q. Then the payments as here involved, as paid under the plan do not include the first type of payment that you testified about?

A. That is correct, sir.

[fol. 41] Q. All right.

A. There is purely a mechanics difference between the payroll records I was looking at and the claim that Mr. Haynes filed.

Q. All right.

Mr. Hudson: Now, may it please the Court, with reference to tender of this document marked Exhibit #6, it appears to be a 1949 Annual Report. Now this we contend, Your Honor, is utterly immaterial and irrelevant, and there may be some portions of it that bear some relevance. I notice a clip on Page 9. May I inquire, with Your Honor's permission, whether the Page 9 and 10 is tendered or just 9?

Mr. Pomeroy: I don't know who put this clip on here, to tell you the truth. I am tendering the entire Annual Report with its various accounting statements as an exhibit #6, and it seems to me the simplest way to introduce it into evidence is to introduce it in its entirety.—

Mr. Hudson: We object to the exhibit as offered by the Government.

The Court: I think the objection would be good. I do not think that because you may have one or two portions of a volume that may have some relevance, that you can burden the record——

Mr. Pomeroy: All right.

The Court: —by introducing the entire volume. Now, [fol. 42] if you wish to delete from that the relevant portions of it, then I will permit you to offer that later, if you wish, but——

Mr. Pomeroy: Well, I would then like to introduce certain portions of this. I hadn't studied it with that in mind too

carefully. Maybe I ought to wait and take a minute or two to look this over, if I may.

The Court: All right.

Mr. Parker, I have one further question. In connection with the charging of these various payments to expense accounts, the sickness disability benefits and the payments made during the first week of absence are both charged to relief accounts, are they not?

A. No, sir. The payments during the first seven days are charged to whatever account would be appropriate for the work that the man normally did.

Q. Would that be the regular wage or salary account?

A. That would be the regular wage or salary account, that is correct.

Q. And during the second week these amounts are charged to the relief accounts?

A. When they are payable under the benefit plan.

Q. Now, if amounts are paid in excess of those authorized under the terms of the plan, amounts that are, in fact, approved by the Benefits Committee, are those amounts also charged to a relief account?

A. That is correct.

Mr. Pomeroy: I have no further questions, Your Honor.

[fol. 43] The Court: Now, is there any question about the amount for which the plaintiff here sues? Is it the contention of the Government that a part of that amount was his regular wages?

Mr. Pomeroy: No, sir.

The Court: As distinguished from sick benefits?

Mr. Pomeroy: The entire twenty-one hundred dollars, as we understand it, was paid pursuant to the plan.

The Court: Under the plan?

Mr. Pomeroy: It is an all or nothing proposition.

The Court: Very well. I just wanted to be sure of that. All right.

Mr. Pomeroy: I have no further questions, Your Honor.

Cross examination.

By Mr. Hudson:

Q. Mr. Parker, what is your position with the Southern Bell Telephone & Telegraph Company?

A. I am, my title is Division Disbursement Accountant, and I am responsible for the payroll and related work for the State of Georgia.

Q. Now, as such employee of this company, briefly—with Your Honor's permission—without saying that Southern Bell Telephone & Telegraph Company all over—you didn't make this book, did you?

[fol. 44] A. No, sir.

Q. And you did not do the mathematical work, the calculations that are in this book?

A. That is correct.

Q. They came to you from someone connected with the company——

A. Yes, sir.

Q. —did they not? Now, I believe, if I remember your testimony correctly, you stated that the check for, or that a check for Mr. Haynes' salary, as an illustration, and a check for the sick benefit payments, the check of itself and on its face would not show what it was for, was that your testimony?

A. That is correct, sir. The check itself, which is detached and deposited in the bank, would not show it, but the stub attached thereto and retained by the employee, would.

Q. Now, you mean that portion of the check called the stub, that stays with the book?

A. No, sir.

Q. When the check is removed and passed on?

A. I might explain that our payroll check, in being tendered to an employee, comprises two parts. The right hand section is the check itself, with the payee's name and the net amount that he is to get from the, from t at check. To the left is a coupon that the employee retains as his information, which reflects what comprises the wage payments, and the deductions that resulted in the net amount that is the check.

[fol. 45] Q. And would also show the difference between a salary check and a sickness benefit check?

A. The gross amount of wages involved in that check, if part of it were regular wages for working, and part of it were sickness payments of another nature, they would be separately stated, yes, sir.

Q. Now, you have those records, do you not, with reference to Mr. Haynes, showing what was paid to him under the sickness benefits plan during the year 1949? You have the checks, or you have the stubs, or what memorandum do you have that would show that?

The Court: Mr. Hudson, it is stipulated here by the Government that the entire amount that you sue for here was paid to Mr. Haynes under the plan, and that no part of it refers to the regular salary.

Mr. Hudson: Well, with that stipulation, then, I don't see the materiality of this particular testimony at all, and I move the Court to strike this witness' testimony heretofore given with reference to the checks insofar as they relate to Mr. Haynes.

The Court: Objection is overruled.

Mr. Pomeroy: I have no further questions, Your Honor, with one reservation. I would like to get portions of this Annual Report into the record before the witness leaves, in case there is any question as to——

The Court: Well, there is considerable question under the, since Mr. Hudson has questioned this witness about the proper identification. While he had heretofore identified [fol. 46] it as being the Annual Report——

Mr. Pomeroy: Yes, sir.

The Court: —that to make that admissible I believe you would have to bring it under the rule with respect to the records of the company, would you not?

Mr. Pomeroy: Well, it was my understanding, in accordance with our conference before we came in here, that this would be admissible in lieu of bringing the Government's, or the company's records in. This is simply a comparative balance sheet, and a profit and loss statement certified to by a public accountant, It would be——

Mr. Hudson: I am sorry that is my good brother's under-

standing, but Your Honor I don't recall having seen this document, or discussed it.

Mr. Pomeroy: I discussed it with you in the Grand Jury room before we came in. Well, if there is some question about it, I don't see any reason why you would object to this.

The Court: What is the relevance of that?

Mr. Pomeroy: If it please the Court, the breakdown in accounting treatment of these various payments, salary payments, and sickness disability benefit payments——

The Court: Well, what does that illustrate?

Mr. Pomeroy: Well, it shows they were charged to general expenses. It shows they were separated from——

[fol. 47] The Court: Well, you have oral testimony in the record to that effect.

Mr. Pomeroy: They were separated from service pensions.

The Court: All of these were charged up to operating expense.

Mr. Pomeroy: And that service pensions appear under separate account. If you feel that this evidence is adequately presented in the record, I will withdraw my tender of this document.

The Court: I don't follow you all the way. I don't know what you are driving at, so I can't say that I feel it is adequately supported in the record because I really don't know what, I don't see the relevance of it.

Mr. Pomeroy: This is perhaps a more graphic explanation of what the witness has said. I think perhaps what he said will be clearer if the various sections of this profit and loss statement to which he has alluded in the record, are in the record.

The Court: You will introduce that simply for showing the method of the treatment rather than to undertake to show the correctness of the particular figures?

Mr. Pomeroy: Yes, sir. Yes, sir.

The Court: Is there any objection to that, Mr. Hudson?

Mr. Hudson: Hearsay, may it please the Court, in addition.

[fol. 48] The Court: All right. I will give you an opportunity to bring the records in and substantiate it. You may send and get the records and bring it in.

Mr. Pomeroy: I have no further questions, then, of this witness.

Mr. Hudson: No questions. Come down.

The Court: You may go down.

(Whereupon the witness was excused from the stand.)

Mr. J. B. Thornton, Jr., being duly sworn, testified as follows:

Direct examination.

By Mr. Pomeroy:

Q. Will you state your address and occupation, please?

A. I live at 420 Landover Drive, in DeKalb County. My title is General Accountant for Southern Bell.

Q. Are you familiar with the salary paid the employees and officers of the Southern Bell Telephone & Telegraph Company during the year 1949?

A. I am.

Q. Could you state——

A. Some of them, I will say.

Q. Could you state in categories such as ten thousand dollar ranges from the President on down what the various employees made, approximately, just so many employees?

The Court: What is the materiality of that?

[fol. 49] Mr. Pomeroy: I want to show, if it please the Court, that this plan covers salaries up in excess of the amounts that he is going to be stating. I want to show the range of the plan, so to speak. We have had testimony——

The Court: Doesn't the plan itself show the range?

Mr. Pomeroy: It doesn't show the salaries, though.

The Court: Well, how is the salaries material?

Mr. Pomeroy: If, for example, it were to develop that employees were paid in excess, for example, of fifty thousand, that would indicate that if this is held by the Court to be health insurance that an employee could be sick for six months, or a year, either twenty five thousand or fifty

thousand dollars tax free under the plan. That is my purpose.

The Court: Well, would that illustrate any issue in here?

Mr. Pomeroy: I think it illustrates, according to our position, that Congress did not intend benefits paid under plans such as this to be excluded from income.

The Court: It is your contention that Congress intended to limit it to amount?

Mr. Pomeroy: I think that Congress didn't intend benefits paid under a plan such as that to be includable at all.

The Court: Then the amount wouldn't have any effect on it.

[fol. 50] Mr. Pomeroy: Well, except for the fact that the larger amounts would tend to indicate that Congress certainly didn't intend a salary of fifty thousand dollars to be excluded from income——

The Court: You think Congress made no mention as to amount——

Mr. Pomeroy: Yes, sir.

The Court: They said there should not be included in income certain funds.

Mr. Pomeroy: Well, health insurance is the issue, as was stated here.

The Court: Well, you think if it was large insurance they did intend it to be included, if it was small they didn't?

Mr. Pomeroy: No, sir, I think they intended no payments under a plan such as this——

The Court: Then the amount would not be material.

Mr. Pomeroy: All right, then I withdraw the witness.

The Court: All right. I think the question we have here is whether it comes within the exclusion or not, and not the question of amount. I don't think the amount would illustrate it in any way.

Mr. Pomeroy: In order to perfect the record I would like to make a proffer of the testimony that this witness would give.

[fol. 51] The Court: I will withdraw my ruling and allow you to put it in the record.

Mr. Pomeroy: All right. Thank you.

The Court: I will state to you that I am allowing it in the record because you want it in the record as a part of

the record. I do not think it has the effect that you think it has, but I will allow it.

Mr. Pomeroy: Yes, sir, I understand.

Mr. Hudson: We want to offer the objection, Your Honor, that it is immaterial and irrelevant to the issues in this case.

The Court: I am doubtful about it, and I will allow it in evidence and overrule the objection. Go ahead.

Q. Mr. Thornton, I would like to ask you if you can give, in roughly ten thousand dollar categories, the salaries of the higher paid officers and employees of the Telephone Company?

A. That is in 1949?

Q. Yes, sir.

A. I presume you are interested in. At the end of 1949—I will give you the number of employees by brackets——

Q. Yes, sir.

A. —of annual pay. Those having the rate of pay as of December 31, 1949, are, between twenty and thirty thousand —up to thirty thousand dollars, there were four employees. Those with annual rate of pay between thirty and forty [fol. 52] thousand dollars, on that same date there were two. Those with a rate of pay of between sixty and seventy were one. Those, that is a total of seven employees at the end of 1949 who had an annual rate of pay of more than twenty thousand dollars a year.

Q. Now, were there any employees in the category from forty to fifty and fifty to sixty?

A. No. I omitted those because there were no employees in there.

Mr. Pomeroy: I have no further questions.

Mr. Hudson: Now, may it please the Court, may I inquire of the Court whether we must renew our objection as the testimony came?

The Court: Well, you may.

Mr. Hudson: Well, I would like to do that, with Your Honor's permission, on the ground that this testimony just elicited from this witness is immaterial and irrelevant, first. Second, I would like to inquire of the witness—I am just basing this objection on the supposition that he didn't make these figures—that this is a record which came to him from

some employee or employees of the Telephone Company.

The Court: Well, under the federal rule, Mr. Hudson, if these are records kept in the regular course of business, whether he kept them or not, it would be admissible here.

Mr. Hudson: If relevant and material to any issue.

[fol. 53] The Court: Yes, sir. That doesn't affect the question of materiality and relevancy, but it does so far as the records are concerned. He wouldn't be required to keep them himself.

Mr. Hudson: Well, we insist that the evidence is immaterial.

The Court: Well, as I stated before, I am very doubtful as to the relevancy of the testimony, but being in doubt about it I will admit it.

Mr. Hudson: Come down.

Mr. Pomeroy: May the witness be excused, Your Honor? I have no further questions.

The Court: You may.

(Whereupon the witness was excused from the stand.)

Mr. LaFayette Davis, having been sworn, testified as follows:

Direct examination.

By Mr. Pomeroy:

Q. Will you state your name, please?

A. LaFayette Davis.

Q. And your address and occupation?

A. General Agent and Branch Manager for the Provident Life & Accident Insurance Company of Chattanooga, Tennessee. Address, the Atlanta Federal Savings Building.

Q. Here in Atlanta?

A. Yes, sir.

[fol. 54] Q. Can you describe very briefly the general nature of your functions as a General Agent?

A. Well, I manage the affairs of the company with particular regard to the life and accident and health and hospital portions thereof in the State.

Mr. Hudson: We object to this testimony, may it please the Court. That is immaterial and irrelevant, and can shed no light on the issues involved in this case.

The Court: What this man's duties are with the company that he works with——

Mr. Hudson: He don't work with the Telephone Company, my understanding is.

The Court: A man doesn't have to work for the Telephone Company in order to be a competent witness.

Mr. Hudson: That is correct, Your Honor, but how his company manages its business is an item entirely separate from the way the Southern——

The Court: He has not asked him how this company managed their business. He simply asked him what his duties were with his company. That is the question to which you are offering your objections.

Mr. Hudson: That is correct, Your Honor, as being immaterial and irrelevant.

The Court: All right. I don't know what you expect to prove by this witness. You may go ahead.

[fol. 55] Mr. Pomeroy: I will state for the purpose of indicating where we are going, I was going to qualify this witness as an expert and elicit certain answers in regard to the nature of health insurance in general, it's background material.

The Court: All right.

Mr. Pomeroy: That is my purpose.—Let the reporter read the last question and answer.

(Whereupon the question and answer were read.)

Q. Are you an agent licensed by the State of Georgia?

A. Yes, I am.

Q. And what are you licensed to do by the State of Georgia?

A. The performance of the functions of a General Agent in the insurance business.

Q. How long have you been an agent in the general insurance business?

A. To distinguish—a General Agent in the general insurance business is not exactly correct. I am a General Agent——

Q. I understand.

A. —in this particular line of insurance. I have been in this position in Atlanta with this company since 1938.

Q. And before that what, briefly, was your occupation?

A. I was on the road for this company as a home office employee since '35.

[fol. 56] Q. And have you had familiarity with the issuance and sale of health insurance policies?

A. Yes.

Q. How long have you had familiarity and experience with the sale and issuance of health insurance policies?

A. Since 1935.

Q. Roughly, how many accident, or how many health insurance policies have you had occasion to sell or issue since 1935? Do you have any idea?

A. No. That would almost be an impossibility to state.

Q. Are you familiar with the health insurance business in the United States?

A. Yes.

Q. Are you familiar with the business of other insurance companies in general, as to their policies in administration?

A. In general, yes.

Q. Are you familiar with limits, if any, on the total of salaries which is insurable under a health insurance policy?

A. In general I am, yes.

Q. Is there a maximum, percentagewise, of an insured's salary which normally can be insured under a health insurance policy?

A. In general there is no insurance company that I know of that would insure a man's salary up to more [fol. 57] than eighty per cent thereof. As a rule we try to keep it slightly below that, particularly in group insurance.

Q. Now, in group insurance, is there a different limit figure that you can give?

A. As a rule it is slightly lower. We try to keep it—I have to say what we do as my experience, but I think it is general with most companies, would be about two-thirds of the salary.

Q. Let me ask you one further thing, preliminary matter. I want to ask you if you hold any official position with any insurance organization?

A. At this time I am Chairman of the Law and Legislation Committee of Georgia Association of Accident and Health Underwriters.

Q. Now, can you state very briefly what your education and training were?

A. I am a graduate of the University of Georgia.

Q. Can you state, or do you know what the policy is behind the limitation of the maximum amount of the salary which can be insured under a particular health insurance policy?

A. You mean the reason why there is a maximum?

Q. Yes.

A. Yes. Because if one could buy insurance for more than his earned income, there would be a moral hazard in the insured's preferring to collect more by being sick than he would by going to work.

Q. Why is the amount, if you know, set less than a [fol. 58] hundred per cent? Why would the figure be eighty per cent or less?

A. So he would have an incentive to return to work as promptly as possible.

Q. Well, do you know of any health insurance, or have you heard of any where the insuring company reimburses a hundred per cent of the insurance?

Mr. Hudson: Your Honor, I don't want to waive any of my rights to object. I object to that as being utterly immaterial and irrelevant. Now, whether this man knows or does not know something about his insurance company or some other insurance company is immaterial, and we object to it.

The Court: I will allow him to show it. I am very doubtful about the relevancy of this line of testimony but I will allow him to put it in the record. Go ahead.

Q. Will you answer the question, please? Do you want it read back?

A. Yes, please.

(Whereupon the question was read back.)

A. I presume you mean insurers for a hundred per cent of the salary?

Q. Yes.

A. I do not know of that.

Q. If an insured had obtained policies from, let us say, several companies, the total coverage of which was either a hundred per cent or in excess of a hundred per cent of his [fol. 59] salary, would a health insurance company pay in a case of sickness the full amount under the policy, or would there be some pro-ration?

Mr. Hudson: I object to that. We are into the realm of, now of speculation.

The Court: Yes. While they have qualified him as an expert, I think that would necessarily depend upon the terms of your insurance contract.

Mr. Pomeroy: Well, I believe I have qualified this gentleman as an expert,——

The Court: Yes, sir.

Mr. Pomeroy: —in the insurance field. I am now asking him a hypothetical question based upon his experience.

The Court: Well, there is nothing in the record upon which to base the hypothetical question that you have asked him. As I understand it, before you can propound a hypothetical question to an expert witness, it must be upon relevant matters that have been developed upon the trial of the case.

Mr. Pomeroy: Well, as I see it, I have proposed a hypothetical situation where several insurance companies issue health insurance policies to one individual, the total coverage of which exceeds the employee's salary, or is equal to the employee's salary, and I am trying to elicit the answer to whether such, whether the insurance company would pay the full amounts under the policy so that an insured could get either a hundred per cent or in excess of a hundred per cent of the salary.

[fol. 60] The Court: Mr. Pomeroy, that is a matter of the, under the question that you have propounded to this witness——

Mr. Pomeroy: Yes, sir.

The Court: —the terms of the insurance contract issued by the companies would control that very question. This witness couldn't answer possibly, even though he is an expert,——

Mr. Pomeroy: All right.

The Court: As to whether the insurance companies would pay.

Mr. Pomeroy: I was asking him from his general knowledge as to what the custom was in the industry. I will withdraw the question if it is troublesome for that reason.

The Court: I don't think his answer could have any sort of probative value,——

Mr. Pomeroy: All right. I will withdraw it.

The Court: —because your question assumes that these companies issue written contracts——.

Mr. Pomeroy: Yes, sir.

The Court: —and that they have agreed, each have agreed to pay certain losses. Now, if they have provisions in those contracts with respect to other insurance, and so forth, then his answer would be one thing, but they must depend upon the terms of those insurance contracts themselves.

Mr. Pomeroy: All right. Well, let me rephrase the question this way.

[fol. 61] The Court: All right.

Q. Is it customary in the health insurance business to provide a limitation in the health insurance contract whereby an insured cannot receive from all outstanding health insurance policies an amount in excess of his salary?

A. There are some contracts issued with the so-called pro-ration clause therein, but those clauses are never in group insurance contracts, and that condition is presumably taken care of at the time of the purchase of insurance rather than at the time of the claim.

Q. All right. From your familiarity with the health insurance business have you ever seen a health insurance policy, or had knowledge of a health insurance policy where the period of time during which the benefits were paid depended on the length of time that the insured has held a particular job?

Mr. Hudson: We object to that, Your Honor. That is immaterial and irrelevant. What this man knows or what this man has seen has no bearing on the issues in this case.

The Court: Well, I think I see what he is driving at, and I doubt the relevancy, materiality of it, but I am going to

allow him to put it in the record. I don't think it is at all controlling in this case.

Mr. Pomeroy: As I indicated before, I am trying to elicit the background as well as I can.

The Court: Well, you have gotten away from background now, but I am going to let you go ahead.

[fol. 62] Mr. Pomeroy: Well, will the Reporter repeat the question, please?

(Whereupon the question is read back.)

A. No, I have not.

Q. Let me ask you——.

The Court: Now, how far do you intend to go in this field? I am going to have to stop you somewhere.

Mr. Pomeroy: I have one further question, Your Honor, and I think I will be completed.

The Court: All right. Go ahead.

Q. Under what circumstances, if any, are physical examinations required in the health insurance industry before insurance is issued?

A. That, of course, will have to be general because there is, several companies could have different rules, but in group insurance there is no evidence of health required, and on individual policies, most cancellable forms of health insurance policies are issued without examination, while most non-cancellable forms of individual policies require examination.

Q. Does the presence or absence of a physical examination ever depend upon the amount of coverage sought by the particular applicant?

A. It could be, yes.

Q. And would it also possibly depend upon the prior history of the applicant in regard to his health?

[fol. 63] A. If evidence of insurability was required, yes, because that would be the reason for the examination.

Mr. Pomeroy: I have no further question, Your Honor.

Cross examination.

By Mr. Hudson:

Q. Give me the name of the company with which you are presently employed, please?

A. The Provident Life & Accident Insurance Company of Chattanooga, Tennessee.

Q. Now, Mr. Davis, have you had occasion, or have you been called upon to read and examine Plaintiff's Exhibit #1 in the case at bar?

A. I have seen it, sir. I have not read it, nor have I examined it.

Q. Now, where did you see it, please?

A. Mr. Pomeroy showed it to me.

Q. Is that the counsel for the Government?

A. Yes, sir.

Q. When did he show you that plan?

A. Yesterday afternoon.

Q. And he subpoenaed you here to testify in this case?

A. Yes, sir.

Mr. Hudson: Come away.

The Court: Go down, sir.

[fol. 64] (Whereupon the witness was excused from the stand.)

Colloquy Between Court and Counsel

Mr. Pomeroy: This is the Government's last witness, if the Court please. Before the Government rests I have a further exhibit. I believe this will be Government's Exhibit #7, which is a certified copy of a statement by the Insurance Commissioner of Georgia. I would like to offer that as an exhibit at this time.

Mr. Hudson: Plaintiff objects to the Government's Exhibit #7 on the ground, first, that it is hearsay, may it please the Court. Second, that it is immaterial and irrelevant. I have had opportunity to examine this particular exhibit, and it seems to be a statement from one Mr. Zack Cravey with reference to the licensing of the Southern Bell Telephone Company to write insurance, and we object to it in its entirety.

The Court: Do you wish to be heard on that?

Mr. Pomeroy: Yes, sir, Your Honor. My position is that that is apparently properly certified copy of the Commissioner's statement and it should be admissible into evidence under the rules.

The Court: Under what rule?

Mr. Pomeroy: I will have to get the rule number.

The Court: As I understand this statement, this is a statement as to what the records do not contain.

Mr. Pomeroy: Apparently so, yes.

The Court: Yes.

[fol. 65] Mr. Pomeroy: I will invite the Court's attention to Rule 44, and that will be the rule.

The Court: What is it? Read it?

Mr. Pomeroy: Well, it is "Proof of Official Records. Authentication of Copy. Proof of Lack of Record.".

The Court: It is your contention this is Proof of record?

Mr. Pomeroy: Proof of Lack of Records.

The Court: Does that provide that?

Mr. Pomeroy: "A written statement signed by an officer having the custody of an official record or by his deputy that after diligent search no record or entry of a specified tenor is found to exist in the records of his office, accompanied by a certificate as above provided, is admissible ..."

The Court: What do you say to that, Mr. Hudson?

Mr. Hudson: That is, as we say, not material and not relevant. We don't think that complies with the rule. There is no—it has not been shown up to now, as we contend, that Mr.,—that there is anything in this certificate that Mr. Cravey himself couldn't come here and tell the Court if it were material or relevant.

The Court: I will overrule the objection. I will allow the statement.

The Clerk: That is Exhibit #7 admitted.

[fol. 66] (Certificate of Mr. Cravey marked and received in evidence as U. S. Exhibit #7.)

Mr. Pomeroy: If it please the Court, again before the Government rests, we have this one other matter of the Annual Report, and I had hoped that opposing counsel and I could work this out now subject to his objections as to materiality and relevancy. These balance sheets and profit

and loss statement can be admitted into evidence without the necessity of calling the corporation's bookkeeper, custodian of the books here and have him testify what the record shows. I don't think there is any question about the accuracy of the figures in here, but the figures aren't introduced into evidence for their accuracy, they are simply to show accounting treatment of these various expenditures. I think in the interest of saving time and expediting the conclusion of this trial if we could introduce these—I think there are three pages—into evidence it would simplify things a great deal.

Mr. Hudson: May it please the Court, I have no desire in the world to be captious, or to impede the Court in the progress of this trial. I have just been handicapped by not having seen this document and having had time to go over it. Now, for the convenience of the Court—I don't think that the plaintiff will have any other evidence—I don't know what time the Court recesses. I hope the Court does recess——

The Court: It doesn't recess at eleven-thirty.

Mr. Hudson: I hope it does recess once in a while. I will be glad to go over this document.

[fol. 67] The Court: How long will it require you? Fifteen or twenty minutes?

Mr. Hudson: Fifteen or twenty minutes.

The Court: We will take a recess, then, for fifteen minutes, then, Mr. Hardegree.

(Whereupon recess was called at 11:28 A.M. EST)

AFTER RECESS

Mr. Hudson: Let's get the Clerk to identify it. This is——

Mr. Pomeroy: Shall we proceed, Your Honor?

The Court: Yes.

Mr. Pomeroy: I think we have settled this Annual Report business. We have ripped out three pages, totaling six front and back, containing the financial statement of the corporation for the year 1949. Mr. Hudson has agreed that this may be received in lieu of the books and records of the corporation as evidence of what these financial statements

contain, that is, the accounting treatment and not the accuracy of the figures.

Mr. Hudson: Without waiving the objection.

The Court: You object on the grounds it is immaterial and irrelevant?

Mr. Hudson: Immaterial and irrelevant.

The Court: I will overrule the objection and allow the evidence.

[fol. 68] The Clerk: That will be marked Exhibit #6 in lieu of the entire report.

(U. S. Exhibit #6 received in evidence.)

The Court: I want to state, Mr. Hudson, that I have allowed in evidence quite a lot of the matter that I do not, under my present view of the case, think is in any sense material or relevant to the issues as I conceive them to be, and if this matter were being tried to a jury my rulings might have been otherwise, but I realize that this particular question that we have here is comparatively new one, and that the Government ought to be permitted full range of the evidence in order to have their views presented and the Appellate Court to pass upon their contentions, and I have been rather generous in allowing the evidence that I consider to be of questionable relevancy for that reason. I just wanted to explain to you my rulings in the matter.

Mr. Hudson: I appreciate Your Honor's explanation, and I appreciate the Court's position. While I appreciate the amount involved in this particular claim is very small——

The Court: Yes, sir.

Mr. Hudson: —nonetheless Your Honor has already observed, and will observe that this plan here not only involves the Southern Bell Telephone Company, but the American Telegraph & Telephone Company, the Western Electric Company, and goes to their associates.

The Court: Yes, sir.

[fol. 69] Mr. Hudson: I see, and saw from the beginning, the importance of this case although this particular amount——.

The Court: Yes, sir.

Mr. Hudson: —is rather small.

The Court: Yes, it involves——

Mr. Hudson: May I say, Your Honor, that I think this is the first time I have ever tried a case on what I call the spur of the moment, without ever having known my adversary, but it has been a genuine pleasure, may it please the Court, and I say that as complimentary to my good brother who presented this case. The case, as far as I see it now, is practically over. May I go a step further, Your Honor? Some of the documents which have been offered and allowed are being photostated. This young lady will require, necessarily, some time to get this record in condition for the Court to approve. I think that our services to the Court are just about terminated for the time being. I don't know whether my good brother Pomeroy is going to agree with me or not. I am going to ask him to go out and eat with me——.

The Court: Well, do we have any further evidence?

Mr. Pomeroy: The Government has not rested. The only thing that remains are those three resolutions which are being photostated now by the Telephone Representative, which will be in the Clerk's hands this afternoon, and we, of course, have agreed that these copies may be introduced in lieu of that manual of the section.

[fol. 70] The Court: Now, they have been allowed in evidence and the record is completed?

Mr. Hudson: That is my recollection.

The Court: Now, I have agreed that the photostats, photostatic copies be substituted for the originals, but that doesn't affect the——

Mr. Pomeroy: Yes, sir, I understand. I just wanted to remind the Court again of that.

The Court: Now, is there anything further?

Mr. Pomeroy: No, sir. The Government rests.

The Court: Anything further for the plaintiff?

Mr. Hudson: The plaintiff rested.

The Court: All right. Now the evidence is closed. You gentlemen want to argue the case?

Mr. Pomeroy: In view of the fact I didn't make any opening statement, I would like to make some brief remarks.

The Court: Very well. Plaintiff has the opening and conclusion.

Mr. Hudson: I will waive the opening argument, may it please the Court.

The Court: All right. Proceed for the Government.

(Whereupon Mr. Pomeroy argued the case to the Court, Mr. Hudson stating he would make his argument in the brief which it was agreed and would be submitted by both parties.)

[fol. 71] Reporter's Certificate to foregoing transcript omitted in printing.

IN UNITED STATES DISTRICT COURT

FINDINGS OF FACT AND CONCLUSIONS OF LAW—Jan. 29, 1955

Plaintiffs, invoking the jurisdiction of this Court under the provisions of 28 U. S. C. A. Sec. 1346 (a) (1), sue here to recover $318.44 income taxes alleged to have been erroneously assessed and illegally collected from plaintiffs.

Plaintiffs contend that $2100.00 paid to Plaintiff, Gordon P. Haynes by the Southern Bell Telephone and Telegraph Company was sickness benefits and as such was exempt from taxation under Title 26, U. S. C. A., Sec. 22 (b) (5). Plaintiffs contend that their timely claim for a refund was disallowed by the Commissioner of Internal Revenue and that they were so notified on June 2, 1954.

[fol. 72] Defendant denies that during 1949 plaintiffs paid to Marion H. Allen, Collector of Internal Revenue for Georgia, by means of withholding tax, $318.44 representing income tax on the sum of $2100.00 paid to plaintiff, Gordon P. Haynes, as sickness disability benefits for the year 1949 by the Southern Bell Telephone and Telegraph Company, but admits that plaintiffs paid $723.84 in income tax liability for the year 1949.

Defendant admits that plaintiffs filed a claim for refund and that the same has been disallowed by the Commissioner of Internal Revenue and that plaintiffs have been so notified, but denies that said tax was erroneously assessed or illegally collected.

Findings of Fact

The plaintiff, Gordon P. Haynes, in 1949 had been employed by the Southern Bell Telephone and Telegraph Company, hereinafter referred to as "the company," for more than 25 years and in that year he became sick and was paid in sick disability benefits under the Plan hereinafter described, the sum of $2100.00 from which the company withheld the sum of $318.44 for income taxes on such sum and the $318.44 was paid by the Company to the Collector of Internal Revenue. The plaintiffs filed a claim for refund alleging that such amount was improperly withheld and this claim for refund was thereafter rejected by the Commissioner of Internal Revenue and the present action was instituted by plaintiffs to recover the $318.44 and interest.

In 1913 the company inaugurated a "Plan for Employees' Pension, Disability Benefits and Death Benefits" which plan, with amendments, is still in force and effect. [fol. 73] Under this plan the company "undertakes to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness, or when they are retired from service, or, in the event of death, to their dependent relatives." The plan provides, inter alia, for sickness disability benefits to all employees of more than two years service with the company and the payments generally begin upon the eighth day of absence from work, but when an employee has received benefits and is absent on account of illness within two weeks of the termination of benefits, the payments begin as of the first day of absence. The amounts paid and the length of time over which the payments are made are governed under the plan by the length of service of the employee with the company and under such provisions of the plan an employee, such as plaintiff here, who had a term of employment with the company of 25 years, or more, may receive as sickness disability payments full pay for a total period of 52 weeks.

Under the plan sickness disability benefits are not payable during a period of layoff and no employee has a right to such benefits after his discharge. The plan is subject to change and may be terminated, but such termination can

not affect rights to which an employee had become entitled prior to such termination.

The plan is administered by a general committee of five members who are appointed and serve during the pleasure of the board of directors of the company and the committee is responsible to the board and the president of the company. The members of such committee are appointed from the operating heads of the various departments of the [fol. 74] company and the majority of their time is devoted to company affairs and not over three hours a week is devoted by the members of the committee to committee work.

All employees, regardless of his or her salary, except those who have worked less than two years with the company, are covered by the plan and they are not required to take a physical examination or to make application in order to receive benefits under the plan. The plan only covers employees of the company and no contribution of cash or other thing of value is required or made by employees in order to be covered by the plan and to receive benefits thereunder.

Under the plan employees receive their regular pay during the first week of absence on account of illness and subsequent weeks are paid under the plan, and all such payments, including payments for the first week, are listed on the company's records as sickness benefits. In case of absence of an employee for sickness, the sickness disability payments to such employee are authorized by the secretary of the committee subject to later approval or ratification by the committee and the committee is authorized by the board of directors to approve payments to employees in excess of those provided for in the plan, and such payments are made in needy cases. The committee also has authority to and makes loans to employees from time to time and has authority to deviate from the plan in other respects. Since the inception of the plan the company has never been sued for sickness disability benefits thereunder.

The company maintains no fund from which disability payments are made and all of such payments are charged to [fol. 75] operating expenses. There is no trust or association which administers the disability benefits under the

plan and no reserve is set up on the books of the company against which disability payments are charged. There is no insurance reserve, and unlike payments to the pension fund under the plan, the cost of sickness benefits is not determined by contributions on an actuarial basis. Payment to an employee for time actually worked and for sickness benefits in a single biweekly pay period is generally in a single check, and in cases where an employee works part of a day and is entitled to sickness disability benefits for the remainder of the day, the entire amount paid to him for that day is charged to his regular salary account. Approximately 2% of the company's payroll in 1949, the year involved here, comprised sickness disability benefits and a total of $1,700,000.00 was paid as such benefits under the plan in that year.

The company is not licensed by the State of Georgia to engage in the business of health insurance.

Private insurance companies who write health insurance do not usually insure a person for more than 80% of the salary earned by such person, and in group health insurance, the limitation is approximately 2/3 of the salary earned, the reason for this being to provide incentive for the insured to return to work as soon as possible, and it is not the practice of such companies to issue policies where the period of time during which benefits are to be paid depends upon the length of time the person has held a particular job or position.

Conclusions of Law

This Court has jurisdiction of the cause.

[fol. 76] The $2100.00 received by the plaintiff, Gordon P. Haynes, from which the $318.44 income tax was withheld, was paid to him as sick benefits and constituted amounts "received through health insurance . . . as compensation for sickness," within the meaning of Title 26, U. S. C. A., Sec. 22 (b) (5), and the inclusion of such amount in the gross income of plaintiffs was improper.

The view of the defendant that the payments were "additional compensation" or "compensation for past services" does not find support in the record.

The employer becomes the insurer and the benefits are

paid only when the employee is ill—if he is not ill, he does not receive them.

Only the value of the protection may be properly treated as additional compensation or income—not the benefits which depend not upon service, but upon duration of illness.

It was held in Epmeier v. United States, 199 F. 2d 508 (4) (7th Cir.):

> "Where employer for adequate consideration agreed and became liable under agreement to pay, and did pay, sickness benefits to an employee based on a reasonable plan of protection to employees, employee was entitled to benefits of provision of Internal Revenue Code excluding from gross income and exempting from taxation amounts received through health insurance as compensation for sickness, notwithstanding there was no formal contract of insurance."

This question has thus been decided adversely to the contentions of the defendant and it seems that the Com- [fol. 77] missioner of Internal Revenue has refused to follow that holding (See 39 A. B. A. 450), although that opinion seems to this Court to be sound.

The plaintiff is entitled to recover. A judgment in accordance with the findings here made may be presented.

This the 28th day of January, 1955.

/s/ Boyd Sloan, United States District Judge

Filed Jan. 29, 1955.

[fol. 78] IN THE UNITED STATES DISTRICT COURT

JUDGMENT—Feb. 8, 1955

Pursuant to a decision of this Honorable Court under the date of January 29, 1955, on the finding of fact submitted to the Court upon the trial of said case, and further pursuant to the conclusions of law as found by the Court, the Court findings that this Honorable Court has jurisdiction of the cause, and that the amount of $2100.00 received by the plaintiff, Gordon P. Haynes, from which $318.44

was withheld, was paid to him as sick benefits and constituted amounts "received through health insurance . . . as compensation for sickness within the meaning of Title 26 U. S. C. A. Sec. 22 (b) (5), and that it was improper to include such amount in the gross income of plaintiffs.

Therefore, it is ordered, considered and adjudged that the plaintiffs, Gordon P. Haynes and Essie M. Haynes, do have and recover of the defendant, The United States of America, the sum of $318.44 principal, and interest at the rate of 6% per annum for a period of five years, 1950 through 1954 inclusive, in the amount of $95.55, totalling 413.99.

This 8th day of February, 1955.

/s/ Boyd Sloan, United States District Judge

John H. Hudson, Wm. R. Hudson, Counsel for Plaintiffs, 521 Connally Bldg., Atlanta 3, Georgia.

Filed and Entered Feb. 8, 1955.

[fol.] IN UNITED STATES DISTRICT COURT

AMENDED JUDGMENT—Feb. 18, 1955

Upon motion of all the parties hereto, and the parties hereto agreeing,

It is ordered, adjudged and decreed that the judgment entered by this Court on the 8th day of February, 1955, be and the same is, amended by striking the provision therein "and interest at the rate of 6% per annum for a period of five years, 1950 through 1954 inclusive, in the amount of $95.55, totalling $413.99" and inserting in its place "with interest according to law."

This 18th day of February, 1955, *nunc pro tunc* as of February 8, 1955.

This amended judgment agreed and consented to.

/s/ Boyd Sloan, United States District Judge

/s/ John H. Hudson, /s/ William R. Hudson, Attorneys for Plaintiffs.

/s/ James W. Dorsey, United States Attorney; /s/ Slaton

Clemmons, Assistant U. S. Attorney; /s/ Charles D. Read, Jr., Assistant U. S. Attorney, Attorneys for Defendant.

Filed and entered Feb. 18, 1955.

[fol. 80] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed March 29, 1955

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment entered in this action on February 8, 1955, as amended February 18, 1955.

This 29th day of March, 1955.

James W. Dorsey, United States Attorney; Slaton Clemmons, Assistant United States Attorney; Charles D. Read, Jr., Assistant United States Attorney, Attorneys for Defendant.

Filed in Clerk's Office March 29, 1955.

[fol. 81] IN UNITED STATES DISTRICT COURT

ORDER EXTENDING TIME—May 5, 1955

Upon consideration of the above and foregoing Motion for Extension of Time, it is ordered that the time for filing the record on appeal and docketing the appeal in the above proceeding be, and the same hereby is, extended for a period of fifty (50) days from and after May 8, 1955.

This 5th day of May, 1955.

/s/ Frank A. Hooper, United States District Judge

Motion omitted.

Filed May 5, 1955.

[fol. 82] IN UNITED STATES DISTRICT COURT

ORDER RE ORIGINAL EXHIBITS—June 21, 1955

It is ordered that all original exhibits be transmitted to the United States Court of Appeals for the Fifth Circuit as a part of the record in the above proceeding, in lieu of copies, because of lack of facilities for copying said exhibits.

This 21st day of June, 1955.

Frank A. Hooper, United States District Judge

Filed in Clerk's Office June 21, 1955.

F. L. Beers, Clerk.

[fol. 83] IN UNITED STATES DISTRICT COURT

DESIGNATION OF RECORD ON APPEAL—Filed June 21, 1955

Pursuant to Rule 75(a) of the Federal Rules of Civil Procedure the defendant-appellant herein, United States of America, hereby designates for inclusion in the record on appeal to the United States Court of Appeals for the Fifth Circuit, taken by notice of appeal filed on March 29, 1955, extension of time for filing the record and docketing the appeal having been granted by the District Court for the Northern District of Georgia to June 27, 1955, the following portions of the record and proceedings in this action:

1. Entire record.

/s/ James W. Dorsey, United States Attorney, Attorney for Defendant.

/s/ Slaton Clemmons, Assistant U. S. Attorney.

Filed June 21, 1955.

[fol. 84] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 84a] PLAINTIFF'S EXHIBIT No. 1

Plan for Employees' Pensions, Disability Benefits and Death Benefits.

Southern Bell Telephone and Telegraph Company

Effective January 1, 1913, with Amendments to and Including the Amendment Effective January 26, 1953.

[fol. 84b] SUMMARY OF PLAN FOR EMPLOYEES'

PENSIONS, DISABILITY BENEFITS AND DEATH BENEFITS

Effective January 1, 1913, with amendments to and including the amendment effective January 26, 1953.

This pamphlet describes the "Plan for Employees' Pensions, Disability Benefits and Death Benefits" of the

Southern Bell Telephone and Telegraph Company

A similar Plan has been adopted by the American Telephone and Telegraph Company, the other Associated Operating Companies of the Bell System, the Western Electric Company, Incorporated, and by certain Companies subsidiary to or affiliated with the aforementioned companies, and agreements for interchange of benefit obligations have been made as provided in Section 9 of the Plan.

A brief summary of benefits to which employees may become entitled is given below. For a complete statement, reference should be made to the Plan. It is contained in pages 5 to 23.

1. Pensions.

(1) Retirement on pension is provided for employees coming under the classes listed below. Employees in Class A may be retired on a service pension either at their own request or with the approval of the Committee. Employees in Classes B and C may be retired on a service pension only with the approval of the Committee.

a) Service Pensions

Class A—Employees whose age is 60 years or more (females 55 or more) and whose term of employment has been 20 years or more.

Class B—Employees whose age is 55 to 59 years (females 50 to 54) and whose term of employment has been 25 years or more.

Class C—Employees whose age is less than 55 years (females less than 50) and whose term of employment has been 30 years or more.

b) Disability Pensions

Class D—Any employee whose term of employment has been 15 years or more and who becomes totally disabled by reason of sickness or accidental injury occurring outside of employment, upon being retired from active service by reason of such disability, shall be granted a disability pension, which shall continue so long as the employee is prevented by disability from resuming active service with the Company: provided however, that, if at retirement the employee is qualified for a service pension, a service pension shall be granted instead of a disability pension.

2) The amount of the annual pension in any of the above cases is 1% of the average annual pay for 10 consecutive years, multiplied by the number of years in the employee's term of employment. Except for disability pensions granted employees with less than 20 years service and pensions granted to "part time" employees, the minimum persion will be $100 per month after age 65 and $75 per month before that age.

Note: Pensions, whether minimum or not, are subject to all applicable provisions of the Plan, including adjustment as provided by Paragraph 28 of Section 8 on account of benefits under the Federal Social Security Act. Thus service pensions are adjusted by one-half the amount of the old-age insurance benefit under the Act as in effect at the time of retirement or August 31, 1952, whichever is later.

[fol. 84c] 2. Accident Disability Benefits.

Total Disability—Full pay 13 weeks (or longer in cases stated below), half pay for remainder of disability.

Partial Disability—For first 13 weeks (or longer in cases stated below), 100% of loss in earning capacity; for re-

mainder of disability, 50% of loss in earning capacity. Period of payments not to exceed six years in all.

For employees with 15 years or more of service, the periods stated as 13 weeks are increased to the full pay periods in the schedule of Sickness Disability Benefits below if the disability originated on or after January 1, 1940.

3. Sickness Disability Benefits.

These benefits commence on the eighth calendar day of absence on account of sickness or accidental injury occurring outside of employment and the sickness disability benefits in such cases originating on and after January 1, 1940 shall be as follows:

a) If term of employment has been 2 to 5 years—full pay 4 weeks; half pay 9 weeks.
b) If term of employment has been 5 to 10 years—full pay 13 weeks; half pay 13 weeks.
c) If term of employment has been 10 to 15 years—full pay 13 weeks; half pay 39 weeks.
d) If term of employment has been 15 to 20 years—full pay 26 weeks; half pay 26 weeks.
e) If term of employment has been 20 to 25 years—full pay 39 weeks; half pay 13 weeks.
f) If term of employment has been 25 years or more—full pay 52 weeks.

Note: These benefits are not provided in the Plan for employees of less than two years' service. In such cases such practice as the Company may establish from time to time will be followed.

4. Death Benefits.

Benefits in case of Death of Active Employee—If the employee leaves a wife who was living with him at the time of his death, a husband who was physically or mentally incapable of self-support and who was actually supported by the employee at the time of her death, or a child under the age of 18 years (or over that age if physically or mentally incapable of self-support) who was actually supported by the employee at the time of death, the amount to be awarded is the maximum specified in the schedules.

In all other cases the amounts to be awarded (within the

limits indicated by the schedules) and the persons to whom the payments shall be made are subject to the discretion of the Benefit Committee.

Beneficiaries are limited to a wife (or husband), dependent children and other dependent relatives of the deceased.

The Death Benefit schedules are:

[fol. 84d] a) Accident Death Benefits

Regardless of the employee's term of employment an Accident Death Benefit not to exceed the amount specified below may be paid in case of death by accident arising out of and in the course of employment:

Three years' pay, not to exceed $10,000; provided, however, that if a greater amount could have been paid under the Sickness Death Benefit schedule below, in a case to which that schedule applies, the maximum of $10,000 is increased to the amount of the Sickness Death Benefit.

In addition to the Accident Death Benefit the necessary expenses of burial, not to exceed $250, will be paid.

b) Sickness Death Benefits.

When the death of an employee with two or more years of service results from sickness or accident occurring outside of employment, a Sickness Death Benefit may be paid not to exceed $250 or the maximum shown below may be paid, whichever is greater:

Employee's Term of Employment	Maximum Sickness Death Benefit
2 but less than 3 years	4 months' wages
3 " " " 4 "	5 " "
4 " " " 5 "	6 " "
5 " " " 6 "	7 " "
6 " " " 7 "	8 " "
7 " " " 8 "	9 " "
8 " " " 9 "	10 " "
9 " " " 10 "	11 " "
10 years or more	12 " "

Benefits in Case of Death of Pensioner—In the discretion of the Committee payments may be made in any case of

death of pensioner to the wife (or husband), dependent children or other dependent relatives of the deceased. The maximum amount of such payments shall not exceed the amount which could have been paid under the Sickness Death Benefit schedule if the pensioner had died on his last day of active service. In the circumstances stated below, benefits of at least the amounts indicated will be paid in all cases.

If the pensioner leaves a wife who was living with him at the time of his death, a husband who was physically or mentally incapable of self-support and who was actually supported by the pensioner at the time of her death, or a child under the age of eighteen years (or over that age if physically or mentally incapable of self-support) who was actually supported by the pensioner at the time of death, a Death Benefit shall be paid as follows:

a) If death occurs within one year after retirement—

The maximum Sickness Death Benefit that could have been paid if the pensioner had died on his last day of active service.

b) If death occurs more than one year after retirement—

Not less than (1) the maximum Sickness Death Benefit specified in (a) above reduced by 10% for [fol. 84c] each full year which has elapsed since retirement, or (2) the amount of the annual pension, whichever is greater.

Manner of Payment—The Death Benefits described above will be paid in monthly amounts equal to the monthly wages or monthly pension at time of death, unless otherwise specified by the Committee, except that the Death Benefit payable to a beneficiary qualified under Section 7, Paragraph 4(a) will be paid in equal monthly installments over a period not exceeding 120 months, if the employee or pensioner has filed a written direction to that effect. Death Benefits will cease upon the death of the beneficiary.

5. Effect of Payments Provided by Law.

Under some circumstances as provided in Section 8, Paragraphs 27 and 28 of the Plan, benefits and pensions are

subject to certain adjustments on account of payments provided by law.

Applications for Benefits

Applications for benefits shall follow the approved instructions of the Company. If such instructions are not readily available, applicants should promptly communicate with the Secretary of the Employees' Benefit Committee, to whom should also be addressed other communications with reference to the Plan.

Retirement Age

By action of the Directors of the Company a rule has been adopted which requires that every officer or other employee becoming 65 years of age shall retire at the end of the month in which that age is reached. Provision is made, however, that by specific action of the Directors the operation of this rule may be delayed from year to year with respect to any employee who is performing such services for the Company that continuation in active employment is deemed for the best interests of the service. Pensions will be voted to those persons retired by the operation of this rule who are eligible to pensions under the Plan at the date of retirement.

Employees' Record of Service

Each employee on entering the service of the Company will be given a copy of this pamphlet and, at that time or at such later time as is the practice of the Company, will be required to furnish for the files of the Committee, on a form supplied for that purpose, information regarding his previous service.

Leave of Absence, Lay-Off and Transfers

Attention is called to the provisions in regard to absences from the service contained in Paragraphs 4, 5 and 6 of Section 8 of the Plan. In order that all employees may be treated fairly, the Company has established routines which must be observed if the continuity of the employee's

service is to be preserved in case of transfer from one Company to another and in case of any absence from the service without pay. Failure on the part of the employee to inform himself of these routines and to observe them may result in loss of credit for previous service. Employees may obtain information regarding the routines from their immediate supervisors or from the Secretary of the Employees' Benefit Committee.

[fol. 84f] PLAN FOR EMPLOYEES' PENSIONS, DISABILITY BENEFITS AND DEATH BENEFITS

Effective January 1, 1913, with amendments to and including the amendment effective January 26, 1953

Section 1. Undertaking.

The Southern Bell Telephone and Telegraph Company undertakes in accordance with these Regulations, to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness or when they are retired from service, or, in the event of death, to their dependent relatives.

Section 2. Definitions.

1) In these Regulations the word "Plan" shall mean the Plan for Employees' Pensions, Disability Benefits and Death Benefits, as set forth in these Regulations.

2) The word "Company" shall mean the Southern Bell Telephone and Telegraph Company, a New York corporation, or its successors.

3) The words "President" and "Board of Directors" or "Board" shall mean the President and Board of Directors respectively of the Company.

4) The word "Committee" shall mean the persons appointed by the Board to administer the Plan.

5) The word "Employees" shall mean those persons who receive a regular and stated compensation from the Company other than a pension or retainer.

6) The expression "term of employment" shall mean period of continuous employment in the service of the Com-

pany, or of the Company, the American Telephone and Telegraph Company, the Associated and Allied Companies with which agreements have been made by the American Company for interchange of benefit obligations and any Bell Company predecessor of any of said companies, or in the service of any one or more of said companies. Service in companies subsidiary to, allied with or predecessors of any one of the aforementioned companies will be considered, in determining "term of employment," as service in such aforementioned company, in all cases authorized by appropriate action on the part of such company.

Section 3. Committee.

1) There shall be a Committee of five (5) appointed by the Board to serve during its pleasure, which Committee shall be called the Employees' Benefit Committee. This Committee shall be charged with the administration of the Plan.

[fol. 84g] 2) The Committee shall have the specific powers elsewhere herein granted to it and shall have such other powers as may be necessary in order to enable it to administer the Plan.

3) It shall determine conclusively for all parties all questions arising in the administration of the Plan.

4) It shall be empowered to authorize disbursements according to these Regulations.

5) It shall adopt such By-Laws and rules of procedure as it may find necessary, subject to the approval of the President.

6) It shall be empowered to employ a Secretary and such other assistants as may be required in the administration of the Plan.

7) The expenses of the Committee in administering the Plan shall be borne by the Company.

Section 4. Pensions.

1) a) All male employees who have reached the age of sixty years and whose term of employment has been twenty or more years and all female employees who have reached the age of fifty-five years and whose term of employment has been twenty or more years shall if

they so request, or may at the discretion of the Committee, be retired from active service and, upon such retirement, shall be granted service pensions.

b) Any employee whose term of employment has been thirty years or more, or any male employee who has reached the age of fifty-five and whose term of employment has been twenty-five or more years, or any female employee who has reached the age of fifty years and whose term of employment has been twenty-five or more years may if the case is approved by the Committee as appropriate for such treatment, be retired from active service and, upon such retirement, shall be granted a service pension.

c) Any employee who has become totally disabled as a result of sickness or of injury, other than by accidental injury arising out of and in the course of employment by the Company, and whose term of employment has been fifteen years or more, shall upon retirement by reason of such disability be granted a pension, which pension is designated a "disability pension"; provided, that if, at the time of such retirement, the employee is qualified for a service pension under subparagraph (a) or (b) above, a service pension shall be granted instead of a disability pension. A disability pension shall continue so long as the employee is prevented by such disability from resuming active service with the Company. If the employee recovers sufficiently to resume active service, the disability pension shall be discontinued and if the employee reenters the service of the Company at that time, the period of absence on disability pension shall be considered as a leave of absence and not as a break in the continuity of the employee's service.

2) The annual pension allowance for each employee retired with a pension on account of age, length of service or disability shall be as follows:

For each year of his term of employment, one percentum (1%) of the average annual pay during the ten [fol. 84h] years next preceding retirement, provided, however, that the Committee may, at its discretion, base

such pension upon the average annual pay of the ten consecutive years of service during which the retired employee was paid the highest rate of wages. The minimum pension for all persons on pensions and who may be retired on pensions under this Plan shall be determined as follows:

a) Except in cases covered by sub-paragraph (b) of this Paragraph 2, the minimum pension shall be One Hundred Dollars ($100) per month for a person who has attained age 65 and Seventy-five Dollars ($75) per month for one who has not yet attained age 65.

b) In the case of pensions granted under Paragraph 1 (c) of this Section to employees of less than 20 years' service, and in cases in which, in the opinion of the Committee, the days or hours constituting the employee's normal service have not been adequate to constitute full-time service during the number of years required to establish elgibility to pension in the class under which the employee is retired, the payment, at the discretion of the Committee, may be less than the applicable minimum amount specified in (a) above, but not less than the amount otherwise payable under the provisions of this Plan.

The pensions herein specified are subject to all applicable provisions of this Plan, including adjustment as provided by Paragraph 28 of Section 8 on account of benefits under the Federal Social Security Act.

3) Pensions shall be payable monthly or at such shorter periods as the Committee may determine in each case.

4) Service-pensions granted to employees shall continue from date of retirement to death of pensioner.

5) Regular employment under a salary with this Company or with any company with which arrangements for interchange of benef obligations, as described in Section 9 of these Regulations, have been made directly or indirectly, shall suspend the right of a retired employee to pension payments during the period he continues in such employment.

6) If an officer of this Company is retired on a service pension and thereafter becomes regularly employed for compensation (except as provided in Paragraph 5 of this Section) the service pension of such retired officer shall be reduced during the term of such employment, or over a period equal to the term of such employment, by the amount of compensation received therefor, unless the Committee with the approval of the Board of Directors shall otherwise determine.

7) The Committee shall furnish at least annually to the President a list of all employees qualified to receive service pensions.

8) The Committee shall notify all employees of their eligibility to retire on service pensions at their own request, as they become eligible.

[fol. 811] 9) In order to meet its obligations to pay service pensions (defined in Paragraphs 1(a) and 1(b) of this Section) granted to take effect under the Plan, the Company, effective January 1, 1927, established a trust fund to be known as the "Pension Fund." It undertakes to maintain this Fund by periodic charges to operating expenses and payments to the Fund in such amounts that when employees are retired or become eligible to retire at their own request under the Plan there will be available in the Pension Fund an amount sufficient to provide for them pensions in the amounts stated in the Plan. The Pension Fund shall be held by a trustee or trustees for service pension purposes only and shall be disbursed as directed by the Company from time to time. In case of termination of the Plan, or in case of revocation or other termination of any trust agreement for service pension purposes executed under the Plan, the Company undertakes to preserve the integrity of the Pension Fund as a trust fund to be applied solely to service pension purposes and to take such action as may be necessary or appropriate to insure the application of the entire fund to such purposes. All service pensions granted to take effect under the Plan shall be paid from the Pension Fund either directly or through the purchase of annuities from an insurance company as the Company may determine.

10) In the event of termination of the Plan, the balance in the Pension Fund shall be applied as follows:

First: To making adequate provision for the payment of the full amounts of the service pensions previously granted to retired employees who are on the pension roll as of the termination date, and for the payment of the full amounts of the service pensions to which employees eligible, as of the termination date, for retirement at their own request have then become entitled, such pensions to start upon the employee's retirement from active service.

Second: To making provision, to the extent permitted by the balance, if any, remaining in the Fund after the foregoing provision shall have been made, for the payment of deferred pensions starting at age sixty-five and continuing until the death of pensioner, computed as hereinafter specified, to all employees who have become eligible, as of the termination date, for retirement on service pension with the approval of the Committee, but not at their own request. If the remaining balance in the Fund shall be insufficient, in the judgment of the Company, to provide the full amount of the computed deferred pensions to employees in this group, the amount of the pension to each employee in the group shall be reduced pro rata.

Third: To making provision, to the extent permitted by the balance, if any, remaining in the Fund after the foregoing provision shall have been made, for the payment of deferred pensions starting at age sixty-five and continuing until the death of pensioner, computed [fol. 84] as hereinafter specified, to all employees who have not yet become eligible as of the termination date for retirement on service pension at their own request or with the approval of the Committee, but who have completed a term of employment of ten or more years on that date and would, if continued in active service until the end of the month during which they would attain age sixty-five, complete a term of employment of twenty years on or before the end of that month. If the remaining balance in the Fund shall be insufficient, in the judgment of the Company, to provide the full

amount of the computed deferred pensions to employees in this group, the amount of the pension to each employee in the group shall be reduced pro rata.

Fourth: In the event that there is any remaining balance in the Pension Fund after making provision deemed adequate for the full amount of the pensions hereinbefore specified as payable in case of termination of the Plan, such balance shall be applied solely for service pension purposes in an equitable manner consistent with the purposes of the Plan.

The deferred pensions specified in this Paragraph 10 as payable to employees who have not yet become eligible as of the termination date for retirement on service pension at their own request, shall be computed, without allowance for any payment upon the death of the employee, in accordance with the provisions of Paragraph 2 of Section 4, subject to the provisions of Paragraphs 27 and 28 of Section 8, except that the term of employment used in the computation shall end as of the date of termination of the Plan, the average annual pay used in the computation shall in every case be the average annual pay for the ten-year period ending on the date of termination of the Plan, and the provisions relating to minimum pensions shall not apply. The payment of such deferred pension shall not be contingent upon the employee's continuing in the service of the Company after the termination of the Plan. In all cases such deferred pensions shall be computed on the basis of the employee's age and term of employment as shown by the Company's records as of the termination date. The Company reserves the right to make provision out of the Pension Fund for any or all pensions specified in this paragraph through the purchase of annuities from an insurance company, or in such other manner as the Company may determine. In the case of all pensions for which provision is made through the purchase of annuities from an insurance company, the delivery of an annuity contract to each employee to whom such pensions are payable shall serve to absolve the Company and the Pension Fund from any further obligation for the payment of such pensions. In the case of all pensions for which provision is not made through the purchase of annuities

from an insurance company, the Company's judgment as to the adequacy of the alternative provision made shall be final. If such alternative provision made, as of the termination date, for deferred pensions to employees not then retired or eligible for retirement at their own re- [fol. 84k] quest should thereafter at any time appear, in the judgment of the Company, to be inadequate or more than sufficient to continue the payment of the amounts previously estimated to be payable the remaining payments on all such pensions shall be adjusted pro rata in accordance with the remaining provision available. In lieu of the deferred pensions starting at age sixty-five as provided for in this paragraph, the Company reserves the right to offer to all or specified groups of employees the option of a reduced pension starting at an earlier age, or such other form of payment as may be consistent with the employee equities involved. The Company's judgment as to the amounts and methods of such alternative payments and the groups to which such options are to be offered shall be final. If any pension payable under the provisions of this paragraph amounts to less than Ten Dollars ($10) per month, the Company reserves the right to pay to the employee upon the date the pension becomes payable the commuted value of such pension in a single lump sum.

11) All Disability Pensions (defined in Paragraph 1(c) of this Section) shall be a charge to the operating expense accounts of the Company when and as paid.

Section 5. Accident Disability Benefits.

1) All employees of the Company shall be qualified to receive payments under these Regulations on account of physical disability to work by reason of accidental injury (not including the accidental injuries specified in Paragraph 13 of Section 8 of these Regulations) arising out of and in the course of employment by the Company. Such payments are hereinafter referred to as Accident Disability Benefits.

2) Accident Disability Benefits shall be as follows:

a) Total Disability—Full pay for any period of total disability during the first thirteen weeks of disabil-

ity, and half pay for any period of total disability after the first thirteen weeks of disability.

b) Partial Disability—For any period of partial disability during the first thirteen weeks of disability, 100% of the difference between full pay at time of injury and wages which, in the judgment of the Committee, the employee is capable of earning; for any period of partial disability after the first thirteen weeks of disability, 50% of difference between full pay at time of injury and wages which, in the judgment of the Committee, employee is capable of earning, provided, however, that no payments for partial disability shall be made after the expiration of six years of disability payments.

c) Beginning January 1, 1940, the thirteen-week periods specified above in sub-paragraphs (a) and (b) shall, for accident disability cases originating on and after said date, be increased to conform to the schedule for full-pay periods set forth in Paragraph 2 of Section 6, if the term of employment is 15 years or more.

"Full pay" and "half pay" for the purposes of this paragraph shall be based on the number of hours per week [fol. 841] commonly regarded as constituting full time service, not including overtime, and shall be computed at the employee's rate of pay at the time the disability began.

3) If after a period of total disability the disability becomes partial or after a period of partial disability the disability becomes total, the amount of the benefits shall be changed accordingly.

4) In ascertaining the period during which Accident Disability Benefits shall be paid, the period of disability shall be taken as commencing upon the first day on which, because of disability, a full day's wages is not paid. Successive periods of disability from accident shall be counted together if from the same accident and separately if from different accidents.

5) Accidental injuries shall be considered as arising out of and in the course of employment only where the injury has resulted solely from accident during and in direct connection with the performance of duties to which the em-

ployee is assigned in the service of the Company, or which he is directed to perform by proper authority, or in voluntarily protecting the Company's property or interests, and there must be a clear and well-established history of the cause and circumstances of injury accidentally inflicted, and they must be sufficient to produce the alleged injury, and there must be satisfactory evidence that such injury renders the employee unable to perform his duty in the service of the Company.

6) In case of accidental injury to any employee arising out of and in the course of employment by the Company resulting in permanent loss of a bodily member or loss of its use, special benefits, in lieu of all other benefits on account of such injury, may be awarded by the Committee, provided, however, that such special benefits shall not exceed the payment hereinafter authorized to be paid in case of death from accidental injury, except by specific authority from the Board.

7) In case of accidental injury to any employee arising out of and in the course of employment by the Company, the necessary expenses for "first aid" shall, on approval of the Committee, be paid by the Company. In addition the Company will pay for necessary surgical treatment, but no employee shall have authority to contract any bills against the Company or the Committee and nothing herein shall be held to mean or imply that the Company will be responsible for such bills as an employee may contract or his surgeon may charge. Bills for surgical treatment must be itemized before they will be considered by the Committee. The decision as to whether in any case surgical treatment was necessary and as to what constitutes surgical treatment shall rest with the Committee. At its discretion the Committee may authorize payment of other expenses necessary for the proper care and treatment of the employee, during such period as the Committee may determine.

8) All Accident Disability Benefits and related expenses shall be a charge to the operating expense accounts of the Company when and as paid.

[fol. 84m] Section 6. Sickness Disability Benefits.

1) All employees of the Company shall, after a term of employment of two years, be qualified to receive payments under these Regulations on account of physical disability to work by reason of sickness. Such payments are hereinafter referred to as Sickness Disability Benefits. Such payments shall terminate when disability ceases and shall in no case extend beyond the periods hereinafter mentioned. For the purposes of these Regulations, sickness shall include injury other than accidental injury arising out of and in the course of employment by the Company.

2) Beginning January 1, 1940, the sickness disability benefits in sickness disability cases originating on and after said date shall be as follows:

a) If term of employment has been 2 to 5 years—full pay 4 weeks; half pay 9 weeks.
b) If term of employment has been 5 to 10 years—full pay 13 weeks; half pay 13 weeks.
c) If term of employment has been 10 to 15 years—full pay 13 weeks; half pay 39 weeks.
d) If term of employment has been 15 to 20 years—full pay 26 weeks; half pay 26 weeks.
e) If term of employment has been 20 to 25 years—full pay 39 weeks; half pay 13 weeks.
f) If term of employment has been 25 years or more—full pay 52 weeks.

"Full pay" and "half pay" for the purposes of this paragraph shall be based on the number of hours per week constituting the employee's normal service under his contract of hiring, not including overtime, and shall be computed at the employee's rate of pay at the time the disability began, provided, however, that the benefits shall at no time exceed the pay which the employee would receive, based on his rate of pay and the general schedule of hours per week constituting a full week's service at the time the disability began.

3) Sickness disability benefits shall begin on the eighth calendar day of absence on account of disability, provided, however, that if an employee has received sickness disability

benefits for any period and is again absent on account of sickness within two weeks after the termination of such period, any benefits on account of such further sickness shall begin on the first day of absence instead of on the eighth day.

4) Successive periods of sickness disability shall be counted together as one period in computing the period during which the employee shall be entitled to benefits, except that any sickness occurring after an employee has been continuously engaged in the performance of duty for thirteen weeks shall be considered as a new sickness and not as part of any disability which preceded such period of thirteen weeks.

[fol 84n] 5) Employees shall not be entitled to receive sickness disability benefits for time for which any wages are paid them by the Company.

6) All Sickness Disability Benefits shall be a charge to the operating expense accounts of the Company when and as paid.

Section 7. Death Benefits.

1) In the event of the death of any employee, occurring on or after January 1, 1946 and resulting from accidental injury arising out of and in the course of employment by the Company, hereinafter referred to as death by accident, there may be paid (and, in the circumstances described in sub-paragraph 4(a) of this Section, there shall be paid) an Accident Death Benefit, the maximum amount of which shall be three years' wages, as defined in Paragraph 8 of this Section, but which shall not exceed Ten Thousand Dollars ($10,000); provided, however, that if the maximum Sickness Death Benefit which could have been paid under the provisions of the next succeeding paragraphs had said employee died from sickness rather than from accidental injury, is in excess of said limit of Ten Thousand Dollars ($10,000), said limit shall be increased to the amount of said maximum Sickness Death Benefit. Payment of the Accident Death Benefit, subject to the conditions imposed in Paragraph 5 of this Section and Paragraphs 27 and 28 of Section 8 and elsewhere in these Regulations, shall be made to the employee's beneficiaries as provided in Paragraph 4 of this

Section. In addition to the Death Benefit the necessary expenses of the burial of the deceased employee, not exceeding Two Hundred and Fifty Dollars ($250), shall be paid.

2) In the event of the death of any employee, occurring on or after January 1, 1930 and resulting from sickness as defined in Paragraph 1 of Section 6 of these Regulations, hereinafter referred to as death by sickness, if the employee's term of employment has been two years or more there may be paid (and, in the circumstances described in sub-paragraph 4(a) of this Section, there shall be paid) a Sickness Death Benefit which shall not be in excess of Two Hundred and Fifty Dollars ($250), or an amount computed according to the following schedule, whichever is greater:

Employee's Term of Employment	Maximum Sickness Death Benefit
2 but less than 3 years	4 months' wages
3 " " " 4 "	5 " "
4 " " " 5 "	6 " "
5 " " " 6 "	7 " "
6 " " " 7 "	8 " "
7 " " " 8 "	9 " "
8 " " " 9 "	10 " "
9 " " " 10 "	11 " "
10 years or more	12 " "

Payment of the Sickness Death Benefit, subject to the conditions imposed in Paragraph 5 of this Section and elsewhere in these Regulations, shall be made to the employee's beneficiaries, as provided in Paragraph 4 of this Section.

[fol. 84o]

3) In the event of the death on or after January 1, 1930 of any person who at the time of death is receiving a pension under these Regulations, the Committee in its discretion, but subject to the following provisions of this Paragraph 3, may authorize a Death Benefit to the wife (or husband) or dependent relatives of the pensioner the total amount of which shall not exceed the maximum amount which could have been paid as a Sickness Death Benefit under the terms of Paragraph 2 of this Section if the pen-

sioner had died on his last day of active service. If such death occurs on or after January 1, 1946, and such pensioner leaves any beneficiary bearing the relationship to the deceased and conforming to the other conditions stated with respect to the death of an employee in sub-paragraph 4(a) of this Section, such Death Benefit shall be paid in accordance with the following:

a) If the pensioner's death occurs within one year following his retirement, the Death Benefit shall be the amount of the maximum Sickness Death Benefit that could have been paid if he had died on his last day of active service.

b) If the pensioner's death occurs more than one year after his retirement, the Death Benefit shall be not less than the amount specified above in sub-paragraph (a) reduced by ten per centum (10%) of such amount for each full year which has elapsed since his retirement, and not less than his annual pension allowance as determined under Paragraph 2 of Section 4, whichever amount is greater.

4). The persons who may be beneficiaries of the Accident or Sickness Death Benefit or of payments on the death of a pensioner hereunder are limited to the wife (or husband) and the dependent children and other dependent relatives of the deceased. The amount to be paid in each case and the beneficiary or beneficiaries who shall receive the same, and the share which each shall receive, shall be determined by the Committee, subject to the following provisions and to the provisions of Paragraphs 3 and 5 of this Section.

a) In the event of death by accident the maximum Accident Death Benefit specified in Paragraph 1 of this Section, or in the event of death by sickness, the maximum Sickness Death Benefit specified in Paragraph 2 of this Section, shall be paid, subject to the provisions of sub-paragraph (c) of this Paragraph 4, to the wife of the deceased employee if living with him at the time of his death; to the husband of the deceased employee, if physically or mentally incapable of self-support and actually supported in whole or in part by

the deceased employee at the time of her death; or to the child or children of the deceased employee under the age of eighteen years (or over that age if physically or mentally incapable of self-support) who were actually supported in whole or in part by the deceased employee at the time of death. If the employee leaves both wife (or husband) and a child or children, as here described, the Committee, in its discretion, may pay the [fol. 84p] Death Benefit to or for any one or more of such possible beneficiaries in such portions as it may determine.

b) If there be no beneficiary of the deceased employee as described above in sub-paragraph (a), then, in the event of death by accident, an Accident Death Benefit in an amount not to exceed the amount specified in Paragraph 1 of this Section, or in the event of death by sickness, a Sickness Death Benefit in an amount not to exceed the amount specified in Paragraph 2 of this Section, may be paid to any other person or persons who may be beneficiaries, as defined in the first sentence of this Paragraph 4, and be receiving or entitled to receive support from the deceased employee at the time of his death.

Subject to the limitations expressed in this sub-paragraph (b) the Committee shall have full authority to determine to whom payments shall be made and the amount of the payments, taking into consideration the degree of dependency and such other facts as it may deem pertinent.

c) If the employee or pensioner shall have made written request and shown good cause therefor, the Committee may pay all or a portion of the Death Benefit to a person or persons included in sub-paragraph (b) above, and reduce, by the amount thus paid, the amount which is payable to the persons included in sub-paragraph (a), provided, in the opinion of the Committee good cause for such action still exists at the time of the employee's or pensioner's death.

d) Upon the death of an employee or pensioner, if there be no beneficiary qualified to receive an award under the provisions of this Section, or if the amount

of such award authorized by the Committee be less than the maximum specified in Paragraph 1, 2 or 3 of this Section, as the case may be, the Committee may authorize such payments as may be required to defray the necessary expenses incident to the death of the employee or pensioner and the disability immediately preceding, together with, in the case of death by sickness, the necessary expenses, not exceeding Two Hundred and Fifty Dollars ($250), of his burial, provided, however, that the aggregate amount so paid shall not exceed the maximum benefits specified in said paragraphs.

5) Unless otherwise specified by the Committee the Death Benefit at the death of an employee or pensioner shall be paid in monthly sums equal to the monthly wages or monthly pension paid at the time of his death. In the discretion of the Committee, however, such sums and times of payments may be varied. Notwithstanding the foregoing and subject to the provisions hereinafter included in this Paragraph 5, an employee or pensioner may file with the Committee a written direction that a death benefit payment which may become payable to a beneficiary qualified under Paragraph 4(a) shall be paid, when such amount has been determined, to said beneficiary in equal monthly installments over a period to be specified in such written direction but not to exceed 120 months and benefits shall be paid in accordance with such direction.

[fol. 84q] In the event of the death of a beneficiary who is receiving or is entitled to receive installment payments under this Section, such payments shall cease. In the discretion of the Committee, however, and within the amounts which the deceased beneficiary would have received if he had survived, the Committee may authorize payments in connection with the disability, death and burial of the deceased beneficiary under conditions similar to those described in sub-paragraph (d) of Paragraph 4 of this Section, or may authorize payments to some other person eligible as a beneficiary of the deceased employee or pensioner under the provisions of Paragraph 4.

Upon the death of an employee or pensioner, the Commit-

tee, without awaiting determination of the beneficiary or beneficiaries, if any, to whom the award will be made, may pay an amount equivalent to the wages, disability benefits or pension which the deceased was receiving, to the end of the payroll period in which the death occurs, and such payment may be made to the wife of the deceased, or to some other suitable person selected by the Committee. Such payment, if made, shall constitute a part of the award. In addition the Committee, in its discretion, may authorize payment, before the final settlement, of a part of the award not exceeding Two Hundred and Fifty Dollars ($250), to meet urgent expenses incident to the death and the immediately preceding disability of the deceased. If any of the persons to whom an award may be payable cannot be found or cannot be conveniently communicated with or are incompetent to authorize use of any part thereof for the burial of the deceased and the payment of necessary expenses incident to his death and preceding disability, the Committee, in its discretion may make such payments, as a part of the award, as in its judgment may be reasonable for the proper burial of the deceased and the payment of necessary expenses incident to his death and disability immediately preceding.

6) A Death Benefit shall not be payable in the case of any person who dies after he has ceased to be an employee of the Company, unless such person became disabled by reason of accident or sickness while an employee and continued disabled, until death, to such a degree as to be unable to engage in any gainful occupation. In such cases a Death Benefit may be paid, in the discretion of the Committee, provided it has been furnished from time to time with such proof of continued disability as it may have required and provided it has been permitted to make, or have made by a physician, such examinations of the disabled person as it has deemed necessary in order to ascertain his condition. The amount of the Death Benefit, if any, shall not exceed the amount which could have been paid if the disabled person had died on the day he ceased to be an employee of the Company.

7) All claims for Death Benefits must be made in writing within one year of the death on which the claim is based. In

case notice in writing of the existence of a wife (or husband), child or other dependent relative of a deceased employee or pensioner shall not be served on the Committee within one year after such employee's or pensioner's death, the Committee shall not be required to recognize any claim made by or in behalf of any such person.

[fol. 84r] 8) "Wages" for the purposes of this Section shall mean wages for full time service (not including overtime), computed at the employee's rate of pay at the date of death; provided, however, that if the employee normally serves the Company on less than a full time basis, benefits in case of death by sickness shall be computed on the basis of the time constituting the employee's normal service under his contract of hiring.

9) All amounts payable under this Section shall be a charge to the operating expense accounts of the Company when and as paid.

Section 8. General Provisions.

1) Neither the action of the Board of Directors in establishing this plan for employees' pensions, disability benefits and death benefits, nor any action hereafter taken by the Board or the Committee shall be construed as giving to any officer, agent or employee a right to be retained in the service of the Company or any right or claim to any pension or other benefit or allowance after discharge from the service of the Company, unless the right to such pension or benefit has accrued prior to such discharge. Except in the event of termination of the Plan, no employee shall have any right to a service pension by reason of service less than that specified in Paragraphs 1(a) and 1(b) of Section 4 of these Regulations, nor any right in the Pension Fund unless a service pension authorized by the Committee under the Plan has not been paid, nor any right against the Company to any benefit under the Plan other than the amount to which the employee has theretofore become entitled and which the Committee has directed be paid to that employee under the Plan. In the event of termination of the Plan, no employee shall have any right in the Pension Fund or against the Company except as herein provided.

2) Assignment of pensions or other benefits under these Regulations will not be permitted or recognized.

3) In all questions relating to the term of employment and rates of pay of employees, the decision of the Committee, based upon these Regulations and upon the records of the Company, shall be final, provided, however, that as to service prior to June 1, 1914, the Committee shall have discretion to base its decisions upon the general intent of these Regulations and upon such information as may be obtainable from any source. As to service on or after June 1, 1914, this discretion shall not exist and the Committee shall base its decisions strictly upon the facts in the case as shown by the records of the Company.

4) Any absence from the service without pay, other than absence during a period of disability benefits, or leave of absence or temporary lay-off as defined in Paragraphs 5 and 6 of this Section, shall be considered as a break in the continuity of service unless the Board of Directors specifically authorizes the Committee to consider such absence as a leave of absence, and if any person is reemployed after such a break in the continuity of his service, his term of employment shall be reckoned from the date of such reemployment.

[fol. 84s] 5) Leave of absence shall not constitute a break in the continuity of service, but in the case of any such absence prior to June 1, 1914, which was of more than six months' duration, the period of absence shall be deducted in computing term of employment. On and after July 1, 1914, leave of absence, for the purposes of these Regulations, shall mean leave formally granted in conformity with the rules of the Company, as adopted from time to time, and, except in the case of leave granted by the Board of Directors as provided in Paragraph 4 of this Section and leave on account of continued disability following the expiration of a period of disability benefits, such leave must be obtained at or before the time the absence begins. A leave of absence for a period not exceeding one month, except a leave following expiration of disability benefits, may be granted in accordance with the rules of the Company, without approval by the Committee, and the period of absence shall be credited in computing term of employment, and

the employee shall retain eligibility to benefits during the absence. Leave of absence for any period in excess of one month shall not be effective unless approved in writing by the Committee, and in any case in which such approval is given, the Committee shall indicate whether or not the period of absence is to be deducted in computing term of employment and whether during the absence the employee shall be eligible to benefits under these Regulations. Absence following the expiration of a period of disability benefits shall be considered as a break in the continuity of service unless the employee is granted a leave of absence by the Committee, provided, however, that in its discretion, the Committee may consider any such absence as a leave of absence, if satisfactory evidence is furnished that the disability was continuous during the entire period of absence.

6) Temporary lay-off on account of reduction of force shall not be considered as a break in the continuity of service, but when the total absence from such cause exceeds six months in any twelve consecutive months, the entire period of the last temporary lay-off which extended the total absence beyond such six months in any twelve consecutive months shall be deducted in computing term of employment, and all subsequent periods of lay-off shall be so deducted until the employee shall have been continuously engaged in the performance of duty for a period of twelve consecutive months. On and after January 1, 1946, a period of lay-off shall be considered as temporary if the employee is reemployed, under such conditions as the rules of the Company, as adopted from time to time, may require, within two years. If the employee is not thus reemployed, the continuity of his service shall be deemed to have been broken. No benefits under these Regulations shall be payable during a period of lay-off.

7) Every employee who shall be absent from duty on account of sickness or injury must at once notify his immediate supervisor, and the employee shall not be entitled [fol. 84t] to benefits for time previous to such notice, unless delay shall be shown to have been unavoidable and satisfactory evidence of disability is furnished.

8) All claims for disability benefits, to be valid, must be

made within sixty days from the date of accident or from the first day of absence on account of sickness.

9) Disabled employees wishing to leave home shall obtain from the Committee written approval of absence for a specified time and furnish it satisfactory proof of disability while absent, otherwise no benefits shall be paid for such period of absence.

10) It shall be the duty of disabled employees, when their condition and location do not prevent, to call on the Committee or the Committee's representative at such times as the Committee may require.

11) A disabled employee shall not be entitled to benefits if he declines to permit the Committee to make or have made by a physician, from time to time, such examination as the Committee may deem necessary in order to ascertain the employee's condition, or if he fails to give proper information respecting his condition, or if he prevents the necessary examination by absenting himself from home without arranging with the Committee, or giving satisfactory reasons for not doing so and furnishing the necessary evidence, or if he fails to comply with notice to meet the Committee, at its offices or elsewhere, when his condition and location permit of his doing so.

12) Disabled employees must take proper care of themselves and have proper treatment. Benefits will be discontinued to employees who refuse or neglect to follow the recommendations of the Committee.

13) Death or disability resulting from infection of a cut, abrasion, scratch, puncture, or other wound not immediately disabling and not reported at the time of the occurrence causing the injury, or from sunstroke or frostbite, shall not be classed as due to accident, except at the discretion of the Committee.

14) Payments under the Plan shall be made in conformity with the financial methods of the Company and on orders of or bills prepared by the Committee or such other persons as may be designated by the Committee.

15) Disability benefits will ordinarily be paid at the same intervals of time as would govern the payment of wages to the employee if he were in the performance of duty, but at the discretion of the Committee benefits on ac-

count of continued disability may be paid monthly and on account of disability for short periods when the amounts are ascertained.

16) In case of any grave injury or chronic sickness, if the employee requests that a lump sum be paid in full settlement of all claims under the Plan and against the Company on account of such injury or sickness, the Committee may, [fol. 84u] in its discretion, make full and final settlement with the employee by commuting the benefit payments into a single lump sum payment, which payment shall be the present value computed on a fair basis, of the benefits to which the employee would become entitled during such period as his disability may reasonably be expected to continue.

17) Disability benefits or pensions accrued but unpaid at the death of an employee or pensioner may, in the discretion of the Committee, be paid to the wife of the deceased person or to some other suitable person selected by the Committee, for use in payment of expenses incident to the death of the deceased person or the disability immediately preceding, or for the benefit of any one or more persons who were dependent upon him at the time of his death.

18) Benefits payable to an employee unable to execute a proper receipt may be paid to a relative or other proper person, selected by the Committee, to use for the benefit of the employee and the receipt of such person shall be a sufficient discharge.

19) After an employee has received the maximum Sickness Disability Benefits herein provided for an employee of his term of employment, he shall not be eligible to further benefits on account of sickness until he shall have performed his duties as an employee of the Company for a continuous period of thirteen weeks. If an employee who has received Sickness Disability Benefits shall subsequently become disabled by reason of accidental injury arising out of and in the course of employment by the Company, or if an employee who has received Accident Disability Benefits shall subsequently become disabled by reason of sickness, the period during which benefits are payable on account of such subsequent disability shall not be affected by the preceding period of disability.

20) Benefits shall not be payable for both accident and sickness at the same time to the same person.

21) Granting a pension to an employee or retiring him from employment without a pension during a period of disability benefits shall not terminate or decrease his disability benefits. Granting a pension during a period of disability benefits, however, shall not entitle the employee to any payments on account of the pension, while the disability benefits continue, unless the amount of the pension is greater than the amount of the disability benefits, in which case only such amount shall be paid on account of the pension as may be necessary to make the total amount paid to such employee on account of the disability benefits and the pension equal to the amount he would have received if the pension alone had been paid.

22) "Rate of Pay" as used in these Regulations shall mean the time rate at which the employee is entitled to receive payment for services under the contract of hiring, provided, however, that if the employee's compensation is [fol. 84v] ordinarily computed on other than a time basis, the employee's average compensation (not including compensation for overtime) for so much of the preceding three months as he has been in the service of the Company, may be taken as determining the rate of pay, provided the rate thus computed is not less than the employee's time rate.

23) If an employee of this Company is an employee also of one or more other companies which have adopted plans for employees' pensions, disability benefits and death benefits, similar to that herein described and which have entered into arrangements with this Company directly or indirectly, for an interchange of the benefit obligations to which the companies may be subject under such plans, any pension, disability benefits or death benefit to which such employee or his beneficiaries may become entitled under the plans shall be computed on the basis of the total combined pay which the employee is receiving from all such companies and, except in the case of injury or death due to accident arising out of and in the course of employment by any of such companies, shall be pro-rated among the companies on the basis of the pay the employee was receiving from each company, and this Company shall only pay its share

thus determined. Any maximum or minimum amounts fixed by these Regulations for pensions, disability benefits or death benefits shall apply to the total amount payable by all companies and not to the portion payable by this Company.

24) In case of accident resulting in injury to or death of an employee which entitles such employee or his beneficiaries to benefits under these Regulations, he or they may elect to accept such benefits or to prosecute such claims at law as he or they may have against the Company. If election is made to accept the benefits, such election shall be in writing and shall release the Company from all claims and demands which the employee or his beneficiaries may have against it, otherwise than under these Regulations, on account of such accident. If any persons other than the beneficiaries under these Regulations might legally assert claims against the Company on account of the death of the employee, no part of the death benefit under these Regulations shall be due or payable until there have also been delivered to the Committee good and sufficient releases of all claims, arising from or growing out of the death of the employee, which such other persons might legally assert against the Company. The Committee, in its discretion, may require that the elections and releases above described shall release any other company, connected with the accident, with which arrangements have been made, directly or indirectly, for interchange of benefit obligations, as described in Section 9 of these Regulations. The right of the employee to accident disability benefits under these Regulations shall lapse if election to accept such benefits, as above provided, is not made within sixty days after injury, or within such greater time as the Committee shall, by resolution duly entered on its records, fix for the making of such election. [fol. 84w] 25) Should claim other than under these Regulations be presented or suit brought against the Company or against any other company with which arrangements have been made, directly or indirectly, for interchange of benefit obligations, as described in Section 9 of these Regulations, for damages on account of injury or death of an employee, nothing shall be payable under these Regulations on account of such injury or death except as provided in

Paragraph 26 of this Section; provided, however, that the Committee may, in its discretion and upon such terms as it may prescribe, waive this provision if such claims be withdrawn or if such suit be discontinued.

26) In case any judgment is recovered against the Company or any settlement is made of any claim or suit on account of the injury or death of an employee, and the amount which would otherwise have been payable under these Regulations is greater than the amount paid on account of such judgment or settlement, the difference between the two amounts may, in the discretion of the Committee, be distributed to the beneficiaries who would have received benefits under these Regulations, except that no party to any such suit against the Company shall be entitled to any portion thereof.

27) In case any benefit or pension, which the Committee shall determine to be of the same general character as a payment provided by the Plan, shall be payable under any law now in force or hereafter enacted to any employee of the Company or to his beneficiaries under such law, the excess only, if any, of the amount prescribed in the Plan above the amount of such payment prescribed by law shall be payable under the Plan, except as provided in Paragraph 28 of this Section; provided, however, that no service pension payable under this Plan shall be reduced by reason of any governmental pension payable on account of military service. In those cases where, because of differences in the beneficiaries, or differences in the time or methods of payment, or otherwise, whether there is such excess or not is not ascertainable by mere comparison but adjustments are necessary, the Committee in its discretion is authorized to determine whether or not in fact any such excess exists, and in case of such excess, to make the adjustments necessary to carry out in a fair and equitable manner the spirit of the provision for the payment of such excess.

28) A benefit or pension payment under this Plan shall be reduced by one-half the amount of any related benefit which the recipient would be entitled to receive under the Federal Social Security Act, as in effect at the time the payment is made (computed on the basis of employment included in his "term of employment" as defined in this Plan, and wages

as defined under applicable Federal law, shown by the Company's records), subject to the following conditions:

a) A service pension determined under Section 4, whether in a specified minimum or other amount, shall be adjusted by one-half the amount of the old-age insurance benefit to which a person would be entitled by reason of his above-described employment and wages (1) under the Federal Social Security Act as amended in 1950 in the case of a person retired on or before August [fol. 84x] 31, 1952, and (2) under the Federal Social Security Act as in effect on the date of his retirement in the case of a person retiring after August 31, 1952; provided, however, that such adjustment shall not exceed the amount of adjustment, as so computed, under the Federal Social Security Act as in effect at the time the service pension payment is made.

b) No adjustment shall be made to any death benefit provided under this Plan except with respect to the extent to which the benefits then payable under the Social Security Act exceed those payable under the Act as in effect on November 16, 1949.

c) In the event the Social Security Act is amended to provide for tax contributions which are different in rate as between employer and employees, the adjustment provided for in this Paragraph 28 shall be changed with respect to a benefit or pension granted thereafter by substituting for "one-half" in the computation of such adjustment the ratio which the Company's rate of tax contribution bears to the combined rate of tax imposed upon employer and employees.

29) The Committee shall publish annually to the employees a report of the operations under the Plan.

Section 9. Interchange of Benefit Obligations.

Agreement may be made by this Company with the American Telephone and Telegraph Company for an interchange with that Company and its Associated or Allied Companies, of the benefit obligations to which such Companies may be subject under plans for employees' pensions, disability

benefits and death benefits. The general provisions of such agreement will be:

a) That advance provision for the payment of service pensions shall be made by this Company in such amounts as may be necessary to provide for and fulfill all requirements of the Plan as in effect from time to time.

b) That an employee's term of employment, as hereinbefore defined, shall include employment not only in this Company and the American Telephone and Telegraph Company, but also in any other Company with which reciprocal agreements under this Plan shall have been made by the American Telephone and Telegraph Company.

c) That in case of consolidation or merger with another Company having a similar employees' benefit plan, the Pension Funds of the Companies consolidated or merged shall be combined.

Section 10. Changes in Plan.

The Committee, subject to the provisions of Section 9, with the consent of the President and subject to the approval of the Board of Directors, may from time to time make changes in the Plan set forth in these Regulations, and the Company may terminate said Plan, but such changes or termination shall not affect the rights of any employee, without his consent, to any benefit or pension to which he may have previously become entitled hereunder.

[fol. 84y] DEFENDANT'S EXHIBIT No. 1

The Benefit Plan in '49

A report to Southern Bell Employees on the operation of the Plan for Pensions, Disability and Death Benefits.

To all employees of the Southern Bell Telephone and Telegraph Company:

The Plan for Employee's Pensions, Disability Benefits and Death Benefits provides that the Committee shall pub-

lish annually to the employees a report of operations under the Plan. The Committee submits herewith its report for the year 1949.

General

The Benefit Plan was established "to furnish help to employees at times when it is most needed." In effectuating this purpose further progress was made during 1949 in decentralizing administration of the Plan by authorizing the State Benefit Committees to approve Accident Disability Benefits in their States. With this change the State Committees now have authority to approve Sickness and Accident Disability Benefits as well as Leaves of Absence, which substantially speed up handling those payments and privileges and thus in fact provides the help "when it is needed."

Organization of Committee

As of January 1, 1950, F. M. Malone was appointed to the Committee in place of E. H. Wasson. Members of the Committee, in addition to Mr. Malone, are G. D. Garner, chairman; J. A. Gantt, H. R. Stone and W. A. Thompson. R. V. Davis is secretary.

Sickness and Accidents

During the year there occurred a total of 9229 sickness cases lasting more than seven days, of which 7566 occurred among employees with over two years' service who were thus eligible to Benefits under the Plan. A total of $1,711,428 was paid as sickness disability benefits under the Plan and $1,090,583 for sickness pay during the first seven days of absence was charged to departmental expense. In connection with 214 on the job lost time accidents, a total of $88,107 was paid as accident disability benefits and expenses.

Thus in more than 7700 instances employees had to be absent from the job due to sickness of over seven days or to accidental injury. Your Committee is very glad that through the medium of our Benefit Plan it has been possible to provide payments during these periods.

Death Benefits

There were 140 deaths among active and retired employees during the year. A total of $256,433 death benefits was paid.

Pensions

At the end of the year, 1673 retired employees were receiving pensions, an increase of 135 during the year. Of these, 1322 were service pensions, the security of which is provided by the Pension Trust Fund. At the end of the year this Fund amounted to $55,155,804 irrevocably set aside for the sole purpose of paying service pensions.

On November 16, 1949 the Plan was amended in respect to the minimum pension provisions. The conditions under which employees become eligible to pension and the fundamental formula for computing the amount of the pension was not changed. This formula remains the same—1% of the average annual salary over the last 10 years (or the highest 10 consecutive years) multiplied by the number of years service, represents the computed annual amount of the pension. Prior to the November 16th amendment, if this computed amount was less than $50 a month, full time employees who retired on pension with 20 or more years service would receive the minimum pension of $50 per month, less ½ Social Security Primary Insurance Benefits. Under the amended plan, all full time employees retired on pension with 20 years or more service will receive a pension payment which, when added to their Social Security Benefit, will equal at least $75 per month until they reach age 65 and not less than $100 per month after that age. As a result of this amendment to the Plan, 1225 employees already retired immediately received increased pension payments. The value of this increased income to these retired people can best be gauged by the voluntary expressions received from them, some of which have been published in the Southern Telephone News.

With this change our Plan, already a liberal one, retains its standing in the very forefront of industrial benefit and

pension plans, a comparative position which it has enjoyed since its beginning in 1913.

Employee's Benefit Committee

G. D. Garner, Chairman
J. A. Gantt
E. M. Malone
H. R. Stone
W. A. Thompson
R. V. Davis, Secretary

[fol. 84z]

DEFENDANT'S EXHIBIT No. 3

Whereas, Paragraph 5 of Section 8 of the Plan for Employees' Pensions, Disability Benefits, and Death Benefits of the Company, provides that any absence from the service without pay, other than absence during a period of disability benefits, or leave of absence, or temporary lay-off, as defined in Paragraphs 6 and 7 of said Section, shall be considered as a break in the continuity of service unless the Board specifically authorizes the Benefit Committee to consider such absence as a leave of absence; and,

Whereas, this Board, at its meeting of June 25, 1929, authorized the Employees' Benefit Committee to consider certain specified breaks in the continuity of, or absence from the service, as leaves of absence "(Automatic Rule for Bridging Breaks in Service)" and it is desirable now to extend this authority to bridge breaks in service in cases of lay-offs exceeding two years, resulting from force reductions due to abnormal business conditions;

Resolved: That this Board hereby authorizes the Employees' Benefit Committee in all cases where the facts are sufficient, in the opinion of said Committee, to warrant such action, to consider as a leave of absence, in advance of completion by the employee of ten years of continuous service after the termination of the absence, any absence from the service which began during the period from July 1, 1930 to August 31, 1933, inclusive, due to force reductions, where the person is reemployed prior to January, 1937,

provided the employee was credited with at least one year's service at the time he was laid off.

Approved by Directors, A. E. Mix, Secretary, Sept. 23, 1935.

8/23/37 Expiration date extended to 1/1/38

[fol. 84aa]

DEFENDANT'S EXHIBIT NO. 4

Excerpt from Minutes of Meeting of Board June 23, 1925.

On motion, it was

Resolved: that the resolution adopted by this Board at a meeting held March 27, 1917 vesting the Employees' Benefit Committee with authority respecting the handling of sickness or accident cases outside the Benefit Plan, matters relating to the physical examination of prospective employees and loans or salary advances to employees, be and it hereby is rescinded.

On motion, it was

Resolved: that the Employee's Benefit Committee, in addition to the duties which devolve upon it under the Plan for Employees' Pensions, Disability Benefits and Death Benefits, be vested with jurisdiction over the following matters, with authority to take all necessary actions and to make payments in connection therewith, this authority to be subject to such rules or limitations as the Executive Committee or the President may from time to time prescribe, such matters being

(1) Relief measures, including the payment of salary during absence from work, in cases of sickness or death of active employees or of accident to them, when such cases are not provided for or in the Committee's judgment are inadequately provided for by the Plan for Employees' Pensions, Disability Benefits and Death Benefits.

(2) Temporary relief in cases of sickness or death of employees retired on pension or of accident to them, when such relief is necessary in order to prevent or alleviate serious distress, provided however that pay-

ments for such relief shall not exceed $500 in any one case, except on approval of the President.

(3) Loans or salary advances to active employees in cases of financial emergency or distress.

[fol. 84bb] (4) Measures relating to the physical examination of prospective employees, to the supervision of the health of employees and to the care for sick or injured employees.

No part of the payments to be made or expected to be incurred in connection with the foregoing matters under the above authorities shall be paid out of the Employees' Benefit Fund.

On motion, it was

Resolved: that said Employees' Benefit Committee be and it hereby is authorized to delegate to any officer or other employee of this Company or to a committee or committees created or appointed by it and consisting of officers or other employees of this Company, such powers and duties with respect to the administration of any or all of the above granted authorities as will result, in the judgment of said Employees' Benefit Committee, in the more effectual administration of said authorities.

[fol. 84cc]

DEFENDANT'S EXHIBIT No. 5

Whereas the Board of Directors, at its meeting of April 24, 1944, authorized the Employees' Benefit Committee to make "Other Benefit" payments in certain cases where an employee of this Company dies while absent on military leave granted with eligibility to death benefits under the "Plan for Employees' Pensions, Disability Benefits and Death Benefits," and it is now desired to accord "Other Benefit" treatment in certain other cases not included within that authority;

Resolved: that, effective August 1, 1946, in any case in which, because of the provisions of Section 8, Paragraph 27 of the "Plan for Employees' Pensions, Disability Benefits and Death Benefits" the disability pension, disability benefit or death benefit otherwise payable under the Plan is reduced

or eliminated by reason of governmental payments of the same general character, payable only upon the death or disability of a person having former military service, the Employees' Benefit Committee is authorized and directed as follows:

1. Disability Pensions and Disability Benefit Cases—"Other Benefit" payments shall be made to the employee or pensioner in amounts equal to the deductions from the benefit or disability pension otherwise provided under the Plan which result from such governmental payments.

2. Death Cases—(a) If the employee or pensioner is survived by any of the beneficiaries described in Section 7, Paragraph 4 a of the Plan, "Other Benefit" payments shall be made to or on behalf of such beneficiary or beneficiaries in an amount equal to the deduction from the maximum death benefit provided under the Plan which results from such governmental payments. (b) If the employee or pensioner leaves no surviving beneficiary as described in Section 7, Para- [fol. 84dd] graph 4 a of the Plan, but is survived by any of the beneficiaries described in Section 7, Paragraph 4 b of the Plan, "Other Benefit" payments, not to exceed the amount that would be deducted from the maximum death benefit if the case arose under subparagraph (a) above, may, in the discretion of the Employees' Benefit Committee, be made to or on behalf of such beneficiary or beneficiaries.

3. The "Other Benefit" payments to be made in the cases described in paragraphs 1 and 2 above will ordinarily be paid in the same manner and will be subject to the same regulations as are provided in the Plan for disability pensions, disability benefits or death benefits as the case may be. In the event that a death benefit under the Plan is payable in a case in which "Other Benefits," as described herein, are also payable, such "Other Benefits" will commence upon completion of the death benefit payments under the Plan.

Approved by Directors, Sept. 23, 1946.

[fol. 84ee] DEFENDANT'S EXHIBIT NO. 6

Financial Statements

The financial statements which follow on pages 30 to 33 are summaries of the accounts of the Southern Bell Telephone and Telegraph Company. Since January 1, 1913, the Company has maintained its accounts in accordance with Uniform Systems of Accounts prescribed for telephone companies by Federal authorities—originally by the Interstate Commerce Commission and, since July, 1934, by the Federal Communications Commission.

As required by the effective Uniform System of Accounts, "Telephone Plant in Service," "Telephone Plant Under Construction," and "Property Held for Future Telephone Use" are stated at cost to the Company except that property included therein which was acquired from a predecessor owner is stated at its original cost when first dedicated to public use. The amount classified as "Telephone Plant Acquisition Adjustment" represents certain costs attributable to property purchased from predessor owners.

H. R. Stone, Comptroller.

[fol. 84ff]

COMPARATIVE BALANCE SHEET

ASSETS

		Dec. 31, 1949	Dec. 31, 1948
Plant and Other Investments:			
Telephone Plant (See Page 29)		$783,106,119	$684,070,223
Comprises land and buildings, rights of way, poles, wire, cable, underground conduit, switchboards, telephones, office furniture, vehicles, tools, etc. At December 31, 1949, this property was classified in the accounts as follows:			
Telephone Plant in Service	$770,838,533		
Telephone Plant Under Construction	11,396,986		
Property Held for Future Telephone Use	514,848		
Telephone Plant Acquisition Adjustment	325,752		
Miscellaneous Physical Property		141,832	258,629
Real estate not now held for telephone purposes.			
Other Investments (at cost)		4,294,469	3,326,419
Stocks	$ 4,287,725		
Miscellaneous Items	6,744		
Total Plant and Other Investments		$787,542,420	$687,655,271
Current Assets:			
Cash		$ 6,653,277	$ 9,161,272
Temporary Cash Investments (U. S. Treasury Bills)		2,996,997	
Special Deposits		1,555,494	1,556,562
Working Funds Advanced to Employees		309,691	309,088
Current Receivables		30,352,277	26,286,214
Amounts due for service (less reserves of $279,924 at December 31, 1949), toll settlements and miscellaneous items.			
Material and Supplies		8,687,504	9,935,569
Principally for construction and maintenance purposes.			
Total Current Assets		$ 50,555,240	$ 47,248,705
Prepaid Accounts and Deferred Charges:			
Prepayments		$ 2,112,375	$ 1,922,106
Taxes, cost of directories and other expenses applicable to period after close of year.			
Deferred Charges		911,994	1,189,537
Total Prepaid Accounts and Deferred Charges		$ 3,024,369	$ 3,111,643
Total Assets		$841,122,029	$738,015,619

[fol. 84gg]

LIABILITIES

	Dec. 31, 1949	Dec. 31, 1948
Capital Stock	$435,000,000	$355,000,000
Par value of common stock outstanding. (At December 31, 1949, 5,000,000 shares authorized, 4,350,000 shares outstanding.)		
Funded Debt:		
Forty-year 3% Debentures, due July 1, 1979	$ 25,000,000	$ 25,000,000
Thirty-year 2¾% Debentures, due September 1, 1972	35,000,000	35,000,000
Forty-year 2¾% Debentures, due August 1, 1985	45,000,000	45,000,000
Forty-year 2⅞% Debentures, due July 1, 1987	75,000,000	75,000,000
Total Funded Debt	$180,000,000	$180,000,000
Current and Accrued Liabilities:		
Advance Billing for Service and Customers' Deposits	$ 6,871,153	$ 5,657,888
Accounts Payable and Other Current Liabilities	28,361,290	29,821,802
Amounts owing for payrolls, supplies, toll settlements, and miscellaneous items.		
Accrued Liabilities Not Due	20,484,464	14,060,948
Taxes	$ 17,665,040	
Interest	2,289,583	
Rents	529,841	
Total Current and Accrued Liabilities	$ 55,716,907	$ 49,543,638
Deferred Credits:		
Unextinguished Premium on Funded Debt (After deduction of unamortized discount.)	$ 2,222,336	$ 2,281,520
Other Deferred Credits	71,097	83,834
Total Deferred Credits	$ 2,293,433	$ 2,365,354
Depreciation Reserve	$157,632,710	$144,596,048
Provision to meet loss of investment in Telephone Plant upon its ultimate retirement from service.		

Earned Surplus Reserved			$	$ 3,138,252
Reservations against contingency of refunds to customers in connection with certain pending rate proceedings.				
Unappropriated Earned Surplus			$ 10,478,979	$ 3,372,327
Analysis of Change During 1949:				
Net Income (see page 33)	$ 22,776,897			
Adjustment of Federal Income Tax for prior years	541,848			
Transfer from Earned Surplus Reserved of amounts reserved in prior years	3,138,252			
Miscellaneous additions	8,610			
Total additions	$ 26,465,607			
Dividends declared	$ 18,987,500			
Abandoned projects	146,903			
Miscellaneous deductions	224,552			
Total deductions	$ 19,358,955			
Net increase	$ 7,106,652			
Total Liabilities			$841,122,029	$738,015,619

H. R. STONE
Comptroller

[fol. 84hh]

	Year 1949	Year 1948
Local Service Revenues	$144,205,837	$117,602,491
Toll Service Revenues	95,412,442	88,093,555
Miscellaneous Revenues Revenues from directory advertising, rents, and miscellaneous sources.	11,093,203	9,345,881
Less—Uncollectible Operating Revenues Provision for revenues which may be uncollectible.	1,054,036	790,256
Total Operating Revenues	$249,657,446	$214,251,671
Current Maintenance	$ 51,979,626	$ 47,205,878
Depreciation Expense Provision to meet loss of investment when depreciable property is retired from service, based on rates for the different classes of property designed to spread this loss of investment uniformly over its service life. Represents approximately 4.6% and 4.4% of average investment in depreciable plant in service for 1949 and 1948, respectively.	29,132,268	23,652,439
Traffic Expense Costs incurred in handling messages, principally operators' wages.	58,042,369	55,629,600
Commercial Expense Costs incurred in business relations with customers; pay station commissions; also the cost of directories, advertising, etc.	22,491,012	19,877,265
Operating Rents	5,816,840	4,979,774
General and Miscellaneous Expenses:		
Executive and Legal Departments	889,380	808,689
Accounting and Treasury Departments	9,930,291	9,030,311
Provision for Employees' Service Pensions (See Note)	7,643,003	6,772,900
Employees' Sickness, Accident, Death and Other Benefits	2,308,819	2,204,152
Services Received Under License Contract	2,385,825	2,687,145
Engineering Expense	1,549,739	1,216,461
Other General Expenses	722,807	654,021
Less—Expenses Charged Construction	2,365,704	2,254,904
Total Operating Expenses	$190,476,275	$172,464,631
Net Operating Revenues	$ 59,181,171	$ 41,787,040
Operating Taxes:		
Federal Taxes on Income	$ 12,060,487	$ 6,545,384
Other Taxes Principally state, local, and social security.	19,258,589	16,349,828
Total Operating Taxes	$ 31,319,076	$ 22,865,212
Net Operating Income (Carried forward)	$ 27,862,095	$ 18,921,828

[fol. 84ii]

	Year 1949	Year 1948
Net Operating Income (Brought forward)	$ 27,862,095	$ 18,921,828
Other Income	995,551	1,137,549
Interest charged construction, dividends and miscellaneous income:		
Miscellaneous Deductions From Income (See Note)	654,358	615,869
Income Available for Fixed Charges	$ 28,203,288	$ 19,443,508
Interest on Funded Debt	$ 5,106,250	$ 5,106,250
Other Interest	379,324	410,009
Less—Release of Premium on Funded Debt—Net	59,183	59,569
Total Fixed Charges	$ 5,426,391	$ 5,456,690
Net Income	$ 22,776,897	$ 13,986,818

NOTE: Total current accruals for employees' service pensions amounted to $8,122,837 for 1949 and $7,252,734 for 1948 of which amounts $479,834 for each year was charged to Miscellaneous Deductions from Income in order to comply with accounting requirements of the Federal Communications Commission. The Company and its independent public accountants consider that the latter amount was, in fact, a current operating expense.

H. R. STONE
Comptroller

Lybrand, Ross Bros. & Montgomery

Certified Public Accountants

Certificate of Audit

Southern Bell Telephone and Telegraph Company,
Atlanta, Georgia.

We have examined the balance sheet of Southern Bell Telephone and Telegraph Company as of December 31, 1949, and the related statement of income for the year 1949. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements (pages 30 to 33) present fairly the position of Southern Bell Telephone and Telegraph Company at December 31, 1949, and the results of its operations for the year 1949, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

LYBRAND, ROSS BROS. & MONTGOMERY

Atlanta, Georgia,
February 3, 1950.

[fol. 84jj]

Trustee's Report of Pension Trust Fund

Established by

Southern Bell Telephone and Telegraph Company

Balance in Fund—December 31, 1948		$ 46,742,224
Additions to Fund During 1949—		
Payments into Fund by Company	$ 8,122,837	
Interest Revenue, including gain or loss on investments disposed of	1,354,962	
Total Additions	$ 9,477,799	
Disbursements for pensions during 1949	1,064,219	
Net Increase in Fund		8,413,580
Balance in Fund—December 31, 1949		$ 55,155,804
Comprised of—		
Bonds of Bell Telephone Companies		$ 8,314,140
U. S. Government Obligations		19,751,852
Public Utility, Railroad and Industrial Bonds		26,172,319
Other Investments		446,920
Cash and accrued interest not due		470,573
Total		$ 55,155,803

Note: Securities are shown on amortized basis.

BANKERS TRUST COMPANY, *Trustee*

By W. B. DUNCKEL, Vice President

New York, N. Y.—January 24, 1950.

[fol. 84kk] DEFENDANT'S EXHIBIT No. 7

COMPTROLLER GENERAL'S OFFICE
STATE OF GEORGIA
ATLANTA

Comptroller General,
Insurance Commissioner,
Georgia Safety Fire Commissioner

Zack D. Cravey
Georgia
Fulton County

I, Zack D. Cravey, Insurance Commissioner of the State of Georgia, hereby certify that I have not licensed the Southern Bell Telephone & Telegraph Company to engage in the business of health & accident insurance, nor is any information on file in my office that the said company has ever been licensed by this office or the insurance commissioner to engage in any kind of insurance business.

In witness whereof, I have hereunto set my hand, and caused the seal of the Comptroller General of the State of Georgia to be affixed in the city of Atlanta on this 5th day of January, 1955.

[SEAL] Zack D. Cravey, Insurance Commissioner

[fol. 85] IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

ARGUMENT AND SUBMISSION—Feb. 8, 1956

(Omitted in printing)

[fol. 86] IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 15655

UNITED STATES OF AMERICA, Appellant,

versus

GORDON P. HAYNES and ESSIE M. HAYNES, Appellees.

Appeal from the United States District Court for the Northern District of Georgia.

OPINION—April 20, 1956

Before BORAH, TUTTLE and BROWN, Circuit Judges.

TUTTLE, Circuit Judge: This appeal from a judgment of the district court in favor of the taxpayer raises the question whether payments made by his employer during sick leave, under the employer's disability benefit plan, are exempt from taxation under the provision of Section 22(b)(5) of the Internal Revenue Code of 1939, which exempts [fol. 87] "amounts received through . . . health insurance . . . as compensation for . . . sickness."[1]

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[1] The applicable statute is as follows:

Internal Revenue Code of 1939:

Sec. 22. GROSS INCOME.

(b) [as amended by Secs. 113 and 127, Revenue Act of 1942, c. 619, 56 Stat. 798] Exclusions From Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

. . . . . .

(5) Compensation for injuries or sickness.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on

Taxes are a creature of statute. It is thus the duty of the Court to look to the statute and if the incidence which makes the tax applicable exists, then the tax follows perforce; but if it does not exist, then it is not within the province of the Commissioner of Internal Revenue, by regulations, or the Courts, by judicial legislation, to bring something within the ambit of a tax that Congress has not placed there. This rule must, of course, work both ways. In devising a scheme of taxation Congress may well discern an area of limited dimensions in which it considers that special relief is indicated. It may then determine that carving out a special exemption will not cut so deeply into anticipated revenues as to cause the favoring of the limited class to bear too heavily on the great bulk of the taxpayers. Congress must then [fol. 88] be able to enact a statutory exemption for such limited area with its restricted revenue loss with the assurance that such exemption will not be broadened by judicial fiat into something covering a much larger area and involving manifold greater revenue loss.

Here Congress provided an exemption from gross income of "amounts received . . . through . . . health insurance . . . as compensation for . . . sickness." The taxpayer seeks to have included in such exemption amounts paid to the employe by the employer which in fact comes to him as a continuation of his regular salary during sick leave.

Both parties, in their briefs, discussed at length the particular terms of the voluntary plan put into effect by the employer, the Southern Bell Telephone & Telegraph Company, under which it provided pay benefits to sick or injured employes on a sliding scale, varying from full pay for four weeks, and half pay thereafter for nine weeks for an employe with from 2 to 5 years' service, up to full pay for a year for an employe, such as taxpayer, with 25 years or more. We think the details of the plan are relatively un-

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account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

. . . . . .

(26 U.S.C.A. 1952 ed., Sec. 22.)

important, since it cannot be disputed that there is no separate contract or agreement of insurance covering an obligation to pay any amounts to the company's employees. We think it clear that when Congress limited the exempt payments to "amounts received through health insurance" it had a concept, clearly stated, of amounts the payment of which was definitely and with binding force fixed by an insurance contract between the employe and an insurer or [fol. 89] between the employer and an insurer for the specific benefit of the employe.

In the trial court there was evidence to the effect that sickness and health insurance was not ordinarily written for full salary amounts; that the employer here did not make payments on an actuarial basis in relation to the amount of risk or to any other factor of age, state of health, or anything else; that no reserves were set up as is ordinarily done in the case of insurance, and that benefits were voluntarily fixed by a management committee. The importance of this evidence is not to prove that the company's plan here was unlike insurance, but it was relevant and of great weight to the proposition that when Congress exempted only such amounts as come "through health insurance," it had a clearly defined class in mind, and that this class is readily identified by normally having a bundle of attributes or characteristics associated with the term "insurance." This class of persons whose payments were exempt were those who, for a definite consideration, having an actuarial relation to the benefits provided, paid by them or on their behalf, obtained insurance coverage under ordinary insurance standards. There was thus an ascertainable amount of gross income involved, from which an estimate of loss of revenue to the government could be made. This loss would obviously be quite different from the loss that would result if the class designated by Congress was made to include every employe who received payments of salary or wages by the voluntary action of his employer during sick leave.

[fol. 90] Our reference to the loss of revenue is not intended to suggest that such loss has any part in enabling the Court to construe a tax statute. The government makes no such argument here and we would not consider it if made. The reference to the differing impacts upon the revenue is

cited to indicate that Congress, in adopting an overall scheme of taxation in which the revenue loss of each exemption plays an important part, must choose words of description to set apart those taxpayers or payments within the exemption. In this case the term "through insurance" was the terminology adopted by Congress for this purpose.

We think it clear, without resort to any but the fundamental rule that words are ordinarily to be taken to mean what they usually import to the average person, that Congress meant to give the exemption here only to amounts received through insurance. If it had intended that all payments received as compensation for sickness were to be exempt it would, of course, not have used the words "through insurance" at all. They would clearly have been superfluous and misleading if that had been the intent of the lawmakers.

Appellee here relies on the decision of the Court of Appeals for the Seventh Circuit in *Epmeier v. U. S.* (7 Cir.), 199 F. 2d 508, by which case the trial court doubtless felt bound. Although there are present in the Epmeier case facts that might warrant our distinguishing it from the case before us, we think that even those facts are unimportant in construing the statute here before us. In Epmeier the employe was working for an insurance company, a com-[fol. 91] pany which had the authority to issue health insurance, although no health insurance had actually been issued by it to cover the payments involved in that litigation. The nature of the employer's business was stressed by the Court, but it also construed the purpose of the statute as "to relieve a taxpayer who has the misfortune to become ill or injured, of the necessity of paying income tax upon insurance benefits received to combat the ravages of disease or accident."

With deference to the views of that distinguished Court, we are of the opinion that the purpose of the statute was to exempt from income tax the proceeds of insurance which had been bought and paid for by the payment of premiums consciously and knowingly made for "health insurance." Whatever the activating motive of Congress may have been in passing the law, its intent was clear that the exemption was to apply only to payments received through insurance. The payments made to the taxpayer here by the Southern

Bell Telephone & Telegraph Company during his absence on sick leave were not such payments. They had no relation to health insurance. See *Moholy v. U. S.*, 132 F. Supp. 32 (N.D.Cal.), pending on appeal C.A.9; *Branham v. U. S.*, 136 F. Supp. 342 (D.C.Ky.); and *Herbkersman v. U. S.*, 133 F. Supp. 495 (S.D. Ohio), pending on appeal C.A. 6. These cases deal with similar questions, the first two having been decided by the district court in favor of the government, the third in favor of the taxpayer.

The judgment of the trial court erroneously construed the exemption statute as covering payments which were not, in fact, received through health insurance. It must be reversed and judgment rendered for the appellant.

Reversed and rendered.

[fol. 92] Brown, Circuit Judge, Dissenting:

Admonished as we are, and almost invariably at the behest of the Tax Collector that "Questions of taxation must be determined by viewing what was actually done * * * and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder, we must regard matters of substance and not mere form * * *" *Weiss v. Stearn*, 265 U.S. 242, 68 L.Ed. 1001; "* * * The incidence of taxation depends upon the substance of the transaction * * *." *Commissioner v. Court Holding Co.*, 324 U.S. 331, 89 L.Ed. 981, the result here is difficult to comprehend. For it is the triumph of form over substance. Form is the absolute monarch here not only in requiring *a* contract, but in specifying the type of contract, the nature of the considerations which business men must have applied, and the specific guaranties required.

To be more specific, in the Court's eye, it must be a contract of insurance, named as such, issued by one having unquestioned legal authority to underwrite, calling for the payment of premiums and specifying ascertainable, legally enforceable obligations. The Court states it several ways, but always adds up the same:

> "We think the details of the plan are relatively unimportant, since it cannot be disputed that there is no separate contract or agreement of insurance covering

an obligation to pay any amounts to the company's employees * * *."

And, again, the Congressional concept of the phrase "amounts received through health insurance" is stated to be, "amounts the payment of which was definitely and with [fol. 93] binding force fixed by an insurance contract between the employee and an insurer or between the employer and an insurer for the specific benefit of the employee * * *." The Congressional concept of the *type* of contract is expanded then into a concept as to the *class* of persons affected. But as to the class and as to the type, it is the *paper* which counts: "This class of persons whose payments were exempt were those who, for a definite consideration, having an actuarial relation to the benefits provided, paid by them or on their behalf, obtained insurance coverage under ordinary insurance standards * * *."

I can find no basis for these conclusions either in the inquiry concerning the intent and purpose of Congress as it acted in its dual capacity of creator and defender of the public Treasure, or in the analysis of the factors underlying the nature of insurance. On this latter phase I feel that the Government's contention, essentially adopted by the Court, suffers from two underlying defects: first, it is not for the Government to decide what free men ought to consider a fair bargain, and second, the record and contention that this arrangement lacks the qualities of insurance evidences a surprising lack of understanding of the nature of modern insurance.

As to the Congressional motivation, I accept, of course, the Court's statement that it is not entering into the field of legislative wisdom. I do not for a moment think that the Court bases its conclusion upon the prospective loss of revenue. This supposed concern of Congress is, however, put forward as a likely or probable explanation for the use of [fol. 94] the terminology "through insurance." I am unable either to see any basis for the argument or where it gets us.

I do not know how Congress, in 1939, could keep its legislative grace "within bounds" for succeeding years by knowing then the extent to which health and accident insurance had become a part of the contemporary social-economic

life. Perhaps there is the thought that the situation was automatically, albeit somewhat unconsciously and certainly informally, reviewed from session to session as Congress met, impliedly reapproved the 1939 concept, and then adjourned without amendment. But, finally, since Congress in 1939 could not possibly know the amounts which would be paid in 1949 either as insurance under contracts of insurance or as benefits under employer plans, I hardly see how the proper legislative concern with impact on probable revenues aids us at all.

When it comes to the analysis of the Telephone Company's arrangement here, I must confess that I am confused as to just what the Court does with it. After detailing briefly the supposed deficiencies as an insurance contract, the Court first states, "The importance of this evidence is not to prove that the company's plan here was unlike insurance * * *." But while disavowing such purpose, apparently out of regard to the view this Court has always taken that it is not for Government to intrude itself upon the reasonableness of business agreements made between free men, it arrives at the same result, for instead of saying that the arrangement was "unlike insurance," it merely holds that the beneficiaries of this plan are not within the *class* of persons who have rights under an insurance contract; for [fol. 95] the Court says, "* * * but it was relevant and of great weight to the proposition that when Congress exempted only such amounts as come 'through health insurance', it had a clearly defined class in mind, and that this class is readily identified by normally having a bundle of attributes or characteristics associated with the term 'insurance.'"

I would think that if the plan was sufficiently "like" insurance as to be "insurance" then the beneficiaries of the plan would be within the class of persons covered by "insurance." In this respect it seems to be another argument advanced as proof but then withdrawn.

If so, then premise and conclusion stand alike in terms: Congress said "amounts received through accident or health insurance"; therefore, Congress meant payments made under health insurance contracts.

But the exact mechanism of the Court's process of reasoning is not, in my judgment, significant because, basically,

the attack made by the Government, sustained by the Court, that because of certain supposed deficiencies the arrangement lacks the *quality* of an insurance contract simply will not bear analysis.

There is, first, no magic about an insurance contract. Like any other, it is merely an agreement to pay ascertainable sums upon the happening of indicated contingencies in return for the payment of some consideration. Where the question is whether a person assuming the obligations of an insurer is engaged, or may engage, in the insurance business, as such, the problem may become more complex in [fol. 96] determining whether such person has complied with the common and numerous statutory requirements regulating that particular business.' But here the question is not whether Southern Bell Telephone and Telegraph Company may engage in the general insurance business. The question is: have they made a contract of insurance. If a contract of insurance has been made between the Telephone Company and its employees, it is not open to the Government to challenge its validity on some supposed corporate infirmity or the like. *Charlotte Union Bus Station, Inc.* v. *Commissioner*, 4 Cir., 209 F.2d 586; Francis M. Camp, 21 BTA 962; *J. N. Wheelock et al.* v. *Commissioner*, 16 TC 1435. The elements of an insurance contract are few and simple.[1] The nature of the contract, the agreement to insure, is not

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[1] 44 C.J.S., Insurance:

Page 471, "*Definition.* Fundamentally it is an agreement to pay a sum on the happening of an event, and has been said to be best defined as a contract whereby one undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event. More broadly, however, the term 'insurance,' or 'insurance contract,' or 'insurance policy,' in the sense of the subject matter with which it deals, denotes a contract by which one party, for a compensation called the 'premium,' assumes particular risks of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency * * *."

See also page 477, Disability Insurance, and page 480, Health Insurance.

determined by its form or the label affixed to it; it is judged on substance.[2]

The form is so unimportant that the contract to insure may be oral. 29 American Jurisprudence, Insurance §§127, 129 and, generally, §126.

[fol. 97] But the Court, obsessed with its conviction that the contract of insurance must be in a particular form issued by a particular company, waves all of this to one side because, "the details of the plan are relatively unimportant." The synoptic analysis set forth in Appendix I amply demonstrates that this arrangement satisfied the requirements of a contract[3] of insurance.

The attack on the plan for its intrinsic deficiencies from an insurance standpoint fares no better.

At the outset this should be recognized for what it is: it is the intrusion again of the Commissioner into the business affairs of citizens. He has the right, of course, to impose and collect the taxes incident to the performance of the contract. But he does not have the right to say what contract shall be made nor what consideration shall be followed, nor

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[2] 29 American Jurisprudence, Insurance, §4: "The name by which a company * * *, or its certificates or policies, are designated is not determinative of the question whether * * * its contracts are in the nature of insurance policies * * *. The nature of a contract as one of insurance depends upon its contents and the true character of the contract actually entered into or issued—that is to say, whether a contract is one of insurance is to be determined by a consideration of the real character of the promise or of the act to be performed, and by a consideration of the exact nature of the agreement in the light of the occurrence, contingency, or circumstances under which the performance becomes requisite * * *."

[3] Appendix I is taken verbatim from Taxpayer's brief and illustrates well how material may be effectively presented with graphic force and convenience to the Court.

Undoubtedly impressed by this technique the brief of Robert K. Jewett and Thomas E. Berry, Esqs., *amici curiae*, following a similar format, contains a tabular comparison of the Haynes, Epmeier and Herbkersman cases and is included as Appendix II.

what may be considered a good bargain. He cannot do this directly, nor can he do it by the favorite administrative device of the oblique approach in which, it is urged, the transaction as the Taxpayer says it occurred, could not have occurred because such a course would have been unreasonable.

[fol. 98] But granting the Commissioner the right to supervise contracts, to assay them from the standpoint of inherent business reasonableness or unreasonableness, to give him an over-the-shoulder gentle guidance to business transactions, his objections here are quite inadequate.

It is contended that since the plan calls for the payment of the full weekly salary for the stated periods, there is no incentive upon the part of the employee to return to work, and this stands in contrast to the ordinary commercial policy limiting weekly indemnity to 75 to 80%.[4] Likewise, it is said that since the Company, in its intracompany accounting, charged payments under the disability plan to operating expense; carried them as one of the specified items under the general category of salaries and wages rather than as plan benefits similar to the way they did for payments into the pension fund; maintained no special reserve account; payments were based on salary only not on some actuarial standards; benefits were available to all employees without a specific medical examination; and the company was not obliged to pay premiums over and above the cost of the actual weekly benefits paid kept this from being insurance. Similarly, complaint is made that the administration of the plan is finally in the hands of Company executives whose decision is stated to be final. This proves, it is claimed, that the plan is a gratuitous arrange-[fol. 99] ment only with no contractual obligations and

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[4] Just what is the source of the statements made by the Government concerning the insurance business is quite obscure. Certainly not in this record comprising as it does only the vaguest of words from a local, general agent for one private health and accident company whose testimony, on the whole, shows that he neither posed as an industry-wide expert, nor was he attempting to state the variable conditions upon which underwriters would be bound.

which is further borne out by the fact that no suit has ever been filed under it.

But all of these contentions ignore the real nature of the insurance business. One thing stands out in the long history of the development of insurance: it came into being out of the business necessity of hedging and protecting against contingent hazards. It is the business man then who determines in the first instance what is needed and the nature and extent of the protection sought. The underwriter lays down the terms most generally by adjusting the cost of the insurance upwards or downwards. In this way underwriters will literally insure anything. If a business, therefore, such as the Telephone Company, determined, as it in its judgment saw fit, that good business called for an insurance policy awarding weekly benefits equivalent to this plan, it is certain that it could, and would, be quickly underwritten. The fact that the required insurance called for the payment of 100% of the employees' salary instead of 75 to 80% would, if material at all, be adjusted in the rate. The same would be true concerning the supposed moral risk as payment of the equivalent of full weekly wage is thought to destroy the incentive to return to work. The element cannot be a big one because for the first five years of employment, the full wage benefit is payable only for four weeks and, on a graduated scale, it finally works up to a maximum of fifty-two weeks after twenty-five years. An underwriter might well consider that the personnel standards of the insured company were such as to likely attract and hold conscientious people of high moral responsibility who would not be [fol. 100] beguiled into malingering by the lure of these limited payments. The underwriter would undoubtedly take into account also the counter incentive to remain on the job to assure advancement in pay and position with its cumulative effect of increasing future disability benefits and pension and retirement advantages.

Moreover, this whole argument ignores the widespread postwar development in the field of health and accident insurance in which reliable companies are offering a variety of packaged benefits designed to help the breadwinner over periods of disability from accident or disease.

Health and accident insurance is not normally written upon a prior health examination and even the so-called expert conceded this. Nor is there any basis in the industry for the Government's contention that payments are based upon some actuarial standard. On the contrary, they invariably call for the payment of fixed weekly indemnities.

The premium cost might, in commercial insurance companies, be determined on a so-called actuarial basis, but no underwriter could hope to have a better experience upon which to calculate his premium than that of the Southern Bell Telephone Company whose plan has been in operation since 1913. This leads to the very curious argument that it cannot be insurance because it only costs the Telephone Company what it pays out, and if it were insurance, they would either pay less or pay more. We have progressed far beyond the naive idea that loss is not sustained merely because it is insured. Business knows now that ultimately it [fol. 101] bears its own losses, so that insurance is more and more a catastrophe stop loss and an efficient claims adjusting service. So, wh- for one year or so, the premium cost to the Telephone Company might be much less than the total payments made to employees, it would not be long until there was a reliable ratio between known probable income and outgo. One of the interesting manifestations of the new business point of view toward the real loss is the growth of retrospective rating plans of one kind or another. In this system the ultimate premium paid is dependent upon the particular assured's own loss experience. There are infinite variations in these plans, but in the main they call for the payment of a premium equivalent to losses plus an added arbitrary percentage for claims handling and overhead with or without, at added cost, catastrophe-stop losses. It then becomes a matter of pure business judgment whether any real purpose is to be served by the entry of an insurance company and its policy. Frequently, this is required by external statutory provisions, such as Workmen's Compensation, Motortruck Carrier, Cargo and Public Liability Insurance, Compulsory Automobile Insurance, or the like. But where external conditions do not require the entry of an insurance company, it is but

an ordinary business problem to determine the probable cost by self-insurance as opposed to outside insurance.

This leads naturally to another demonstration that the requirement of an insurance company contract is artificial indeed. Whatever the corporate power under Georgia Law of the Telephone Company to write insurance, it could easily have organized its own health and accident insurance [fol. 102] affiliate. The Company would not have to worry about losses, reserves, or the like because whatever the subsidiary paid out, it would know that it would have paid the same to the employees under the plan. Likewise, being a part of a large family of integrated Telephone Companies, it could easily have organized with other company members of AT&T a mutual insurance company or a Reciprocal Exchange. The essence of each is that the insured is also insurer. Since the exposures would be consistent and uniform, the losses ultimately would fall substantially on each participating member company. The cost then would be what it has always been.

Of course, it is a little absurd to elaborate on what must be such an obvious economic fact: if experience over the years by Southern Bell Telephone Company shows the payment of stated sums as plan benefits, it is obvious that the cost through insurance policies would have to be at least as much and likely more. There is nothing in Section 22(b)(5) to require that an employer discard his own business judgment in appraising the alternative means of giving employees health and accident insurance benefits. Large companies frequently self-insure property and liability exposures of millions of dollars. Unless the Commissioner has the right to veto it, there is no reason why the same policy cannot be followed on a health disability plan whose risks, it must seem obvious, are slight. The criticism that there are no reserves as such, or that the plan is administered by Company executives is likewise superficial. Of course, it is the Commissioner again trying to tell the employee that the security of his "insurance" contract is no good [fol. 103] because there is not a special reserve posted or the management may be prejudiced. But disregarding this, there is no showing that ample funds are not available or that security would better be assured by frozen funds. If

one were required, the Commissioner would likely again enter the picture to determine the nature and kind of investments and perhaps might criticize an investment by the Telephone Company in its own or affiliates' stocks even though our Government follows somewhat the same practice with Social Security revenues.

That there has not been a suit for 30 years over the plan does not prove it lacks legal enforceability. And, again, just what kind of a contract would satisfy the Commissioner? Suppose the employee belongs to a Fraternal lodge which issues a policy or a certificate? Suppose, as is quite common, it is his labor union that provides a specific benefit against specific premium contributions? Is it any less "amounts received through * * * insurance" if, as is so common, the bylaws of the lodge or union vest absolute power in the officers and presumably prohibit claim or suit? Nor is there any assurance that courts would not protect these beneficiaries if, under the terms of the plan, certain weekly benefits had accrued by prior service but were arbitrarily denied by the Telephone Company.

I have discussed these contentions in some detail because I think it important that in this situation it is imperative that substance be the rule of reason.

This plan has all of the attributes of insurance. It is not necessary to satisfy the statute that the plan adhere [fol. 104] to the underwriting principles of any one particular health and accident insurer. Viewed from the standpoint of its reasonableness as an insurable undertaking, the plan is one which would find great acceptance at a premium cost which could soon be calculated. Since it is the Telephone Company's money which will be spent in either case, it has determined in its wisdom that it is better as a business proposition for them to bear the direct and full costs of this, rather than resort to an external third party. By this means, the Telephone Company is able to transfer from the shoulders of its employees the risks of loss of essential income during periods of illness or injury. The employees have paid a valuable consideration for the risk which the employer has taken on. Their "premium" payment has been made through the services performed for the Company

under the employment contract which includes, as a part, this plan:

The statute requires, of course, *insurance* payments. I would certainly agree that mere generosity on the part of an employer in continuing wages would not qualify. But where the employer's plan, carefully integrated and long maintained, makes definite provisions for the payment of specified sums over and above and beyond the wages or salary for work done, the plan and the payments under it should be treated as insurance since that is what it is in fact.

With much deference, I must, therefore, dissent.

[fol. 105]

APPENDIX I TO DISSENTING OPINION

ELEMENTS OF A CONTRACT OF INSURANCE (44 C.J.S. 940)

PROVISIONS OF PLAN IN INSTANT CASE WHICH SATISFY THE ELEMENTS OF AN INSURANCE CONTRACT:

SUBJECT MATTER

"The Southern Bell Telephone and Telegraph Company undertakes in accordance with these Regulations, to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness or when they are retired from service, or, in the event of death, to their dependent relatives." (Pltf. Ex. 1, p. 5.)

RISK OR CONTINGENCY INSURED AGAINST

Loss of income because of employee's inability to work due to sickness. (Pltf. Ex. 1, p. 5, Sec. 1; p. 12.)

THE DURATION OF THE RISK OR CONTINGENCY

Schedule, Pltf. Ex. 1, p. 6, Sec. 6, Para. 2:—

from (a) 2 to 5 years of employment—full pay 4 weeks, half pay 9 weeks.

to (f) 25 years or more of employment—full pay 52 weeks.

Benefits begin on eighth calendar day of absence on account of disability. (Pltf. Ex. 1, p. 12, Sec. 6, Para. 3; also R/40.)

[fol. 106]

Benefits terminate when disability ceases, or period set out in Para. 2 ends. (Pltf. Ex. 1, p. 12, Sec. 6, Para. 1.)

A PROMISE TO PAY OR TO INDEMNIFY IN A FIXED OR ASCERTAINABLE AMOUNT

Schedule of amounts set out in Sec. 6, Para. 2 of the Plan, page 12, Pltf. Ex. 1.

A PREMIUM

Services rendered by the employee:—

Epmeier vs. United States, 199 F.2d 508:

". . . . . service and labor rendered by plaintiff employee to employer was adequate consideration without payment of premium . . . . ."

Herbkersman vs. United States, 133 F. Supp. 495:

p. 496:—"While no monetary consideration is paid by the employee for the protection afforded under the Plan, the acceptance of employment with the Plan being a feature thereof constitutes a full and adequate consideration; consideration need not necessarily be a transfer of money, it may be anything of value."

C.J.S. Vol. 44, page 1323, Para. 349:

[fol. 107]

THE PERIOD OF PAYMENT OF THE PREMIUM

"While premiums are ordinarily payable in cash, the insurer may accept or authorize payment otherwise than in cash."

AN AGREEMENT OF THE PARTIES ON ALL THE ESSENTIAL ELEMENTS

I. T. 4015, C.B., 1950-1, 23, at p. 25:

"The employees' rights to receive benefit payments under a voluntary plan in consideration of their employment and the employer's obligation to pay the benefits satisfy the requirements of contract. Furthermore, it seems clear that the contract is one of insurance, as a voluntary plan assures and promises each qualified employee a fixed compensation for a fixed period in the event accident or sickness renders him unable to work. Such assurance is the basic function of an insurance contract. Therefore, such a plan also meets the requirements of Section 22 (b) (5) of the Code."

Employee must work two years in order to be eligible for benefits. Pltf. Ex. 1, p. 12, Sec. 6, Para. 1; also R/22, 24.

Plan is a part of employment contract between employer and employee.

[fol. 108]

"Each employee on entering the service of the Company will be given a copy of this pamphlet . . . . ." (Pltf. Ex. 1, p. 4.)

The following chart shows some additional elements of insurance as set out in the case of *Epmeier vs. United States*, 199 F. 2d 508:

ADDITIONAL ELEMENTS OF INSURANCE DISCUSSED IN EPMEIER CASE:

UNDER PLAN IN INSTANT CASE:

From employee to employer. Pltf. Ex. 1, p. 5, Sec. 1, Para. 1.

A SHIFTING OF THE INCIDENT OF RISK FROM ONE TO ANOTHER.

Herbkersman vs. United States, 123 F. Supp. 195:

"Under the Plan the employer undertakes to assume the risk which would otherwise be borne by the employee

of loss of income during periods of disability resulting from sickness, and the risk is thereby transferred from the employee to the employer and this transfer of risk creates

"CONTRACTUAL" SECURITY

in itself a contract of insurance." (p. 496.)
Part of contract of employment.

Epmeier vs. United States, 199 F.2d 508:

[fol. 109]

"But we know of no reason why insurance protection must be expressed in a formal contract."
"(4) As we have indicated, we know of no reason why this insurance, when provided as part of the contract of employment between employee and employer, must follow any stereotyped or conventional form. Surely there is no legal magic in form; the essence of the arrangement must determine its legal character. We conclude that the fact that there is no formal contract of insurance is immaterial, if it is clear, as here, that, for an adequate consideration, the company has agreed and has become liable to pay and has paid sickness benefits based upon a reasonable plan of protection of its employees."
C.J.S. Vol. 44, p. 1018, Insurance, Para. 249:
"No particular form of words is required to constitute a contract of insurance."

MEDICAL EXAMINATION PRIOR TO EMPLOYMENT

Not required here.

TREATMENT BY PHYSICIAN DURING DISABILITY

Pltf. Ex. 1, p. 19, Para. 11, 12:

[fol. 110]

"(11) A disabled employee shall not be entitled to benefits if he declines to permit the Committee to make or have made by a physician, from time to time, such examination as the Committee may deem necessary in order to ascertain the employee's condition. . . ."

"(12) Disabled employees must take proper care of themselves and have proper treatment. Benefits will be discontinued to employees who refuse or neglect to follow the recommendations of the Committee."

Epmeier vs. United States, 199 F.2d 508:

(2) . . . . :"The employee is required while ill, to follow the instructions of his physician or the company's physician, a provision closely akin to features of ordinary insurance, where the insurer is interested in avoiding extension of any resulting loss beyond that which can be reasonably avoided."

CONTRACT MAY BE REVISED

Pltf. Ex. 1, page 23, Sec. 10:

"The Committee, subject to the provisions of Section 9, with the consent of the President and subject to the ap-

[fol. 111]

proval of the Board of Directors, may from time to time make changes in the Plan set forth in these regulations, and the Company may terminate said Plan, but such changes or termination shall not affect the rights of any employee, without his consent, to any benefit or pension to which he may have previously become entitled hereunder."

Epmeier vs. United States, 199 F.2d 508:

(4) . . . . "The provision that the terms of the agreement may be changed does not impinge upon the soundness of this conclusion. Employment contracts are always subject to revision. If the terms of such changes are not satisfactory to the employee, he may terminate his service; he can not be forced to work under conditions repugnant to his sense of what is fair and proper. It is obvious also, we think, that no change could be made to defeat or lessen the liability, once it had attached. In the provisions lies the implicit agreement to pay the benefits until and unless the terms should be modified; no such modification

could reduce the liability for sickness benefits after illness had intervened."

[fol. 112] *C.J.S. Vol. 44, Insurance, para. 255, page 1031:*

"Contents" . . . . "a contract of insurance is a voluntary one, and the parties thereto have a right to incorporate therein such provisions and conditions as they see fit to adopt, provided the conditions and provisions are not in violation of law or public policy."

Appendix II to Dissenting Opinion

[fol. 113-114]

	Haynes (Southern Bell Telephone & Telegraph Company Plan)	Epmeier (Lincoln National Life Insurance Co. Plan)	Herbkersman American Telephone & Telegraph Company Plan)
1. Plan stated in written document or booklet distributed to employees.	Yes.	Yes.	Yes.
2. Employee consideration found in employment services rendered—no separate contribution by employees.	Yes.	Yes.	Yes.
3. Duration of benefits based upon length of employment.	Yes.	Yes.	Yes.
4. Amount of benefits (a) based upon salary (b) equivalent to full salary.	(a) Yes. (b) Yes as applicable to Haynes—not determinable as applicable to all employees.	(a) Yes. (b) Not determinable.	(a) Yes. (b) Not determinable.
5. Applicable to all regular employees who have passed a medical examination as an incident to employment.	Yes (medical examination not required.)	Yes.	Yes (does not appear in that employees take medical examination before hired).

6. Benefits commence with first day of illness.	Generally on eighth day of illness, but first day in some cases; regular salary paid during first week and charged as sickness benefits on company records.	Inferable but not definitely determinable.	No payments made for first seven days of absence.
7. Employee while ill required to follow instructions of his or company physician.	Yes.	Yes.	Inferably yes since confirmation of illness by own or company physician required.
8. No benefits for illness or injury due to alcohol, immoralities, brawling, etc.	Not determinable.	Not determinable	Not determinable.
9. Administration of plan.	Committee of 5 appointed by directors from heads of operating departments approves payments.	Office Administration Department. Right to cancel if fullest cooperation not given.	Not determinable.
10. Plan benefits and salary in single check.	Yes.	Not determinable.	Yes, if absence occurs in same pay period as regular payment for actual service.
11. Costs of benefits not determinable under actuarial tables, and no funded reserve.	Yes.	Not determinable.	Not determinable.
12. Plan subject to termination not to affect rights accrued prior thereto.	Yes.	Yes.	Yes.

[fol. 115] IN UNITED STATES COURT OF APPEALS

No. 15655

UNITED STATES OF AMERICA

versus

GORDON P. HAYNES and ESSIE M. HAYNES

JUDGMENT—April 20, 1956

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and judgment here rendered for appellant, United States of America.

"Brown, Circuit Judge, dissenting."

[fol. 116] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 117] SUPREME COURT OF THE UNITED STATES,
October Term, 1956

No. 257

GORDON P. HAYNES and ESSIE M. HAYNES, Petitioners,

vs.

UNITED STATES OF AMERICA

ORDER ALLOWING CERTIORARI. Filed October 8, 1956.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Office - Supreme Court, U.S.
FILED
JUL 13 1956
JOHN T. FEY, Clerk

Supreme Court of the United States

OCTOBER TERM, A. D. 1956.

No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES,
Petitioners,

versus

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, A. D. 1956.

No. .....

GORDON P. HAYNES AND ESSIE M. HAYNES,
Petitioners,

versus

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT, AND APPENDIX.

TO THE HONORABLE THE SUPREME COURT OF THE UNITED STATES OF AMERICA:

Petitioners respectfully petition this Honorable Court to grant the Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit in the above cause.

In this behalf, petitioners show unto the Court:

I.

OPINION OF THE COURT BELOW.

United States of America, Appellant, v. Gordon P. Haynes and Essie M. Haynes, Appellees, ... Fed. (2d) ..... (not yet in print). (Record, page 86; Appendix A.)

II.

STATEMENT OF GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

Date of Judgment to be reviewed, April 20, 1956. (Record, page 115; Appendix B.)

Statutory provision believed to confer on this Court jurisdiction to review the judgment in question:—28 Federal Code Annotated, section 1254 (1). (Appendix C.)

III.

THE QUESTION PRESENTED FOR REVIEW.

The question for decision is: Whether amounts paid to the taxpayer in 1949 by his employer during sick leave and pursuant to his employer's disability benefit plan are exempt from taxation as amounts received through health insurance within the terms of Section 22 (b) (5) of the Internal Revenue Code of 1939.

The District Judge held that they were. (Record, page 78.)

The Court of Appeals held that they were not. (Record, page 91.)

IV.

STATUTE INVOLVED.

The statute involved is:

Internal Revenue Code of 1939, Section 22 (b) (5)—26 Federal Code Annotated, Section 22 (b) (5)—(Appendix D) Page 40.

V.

STATEMENT OF THE CASE.

(a)

The Material Facts.

This action was brought in the United States District Court for the Northern District of Georgia, Atlanta Division, by petitioners, to recover the sum of $318.44 which they allege was illegally collected from them. (Record, pages 1-2.)

Gordon P. Haynes was employed by the Southern Bell Telephone and Telegraph Company, and had been since 1921. During a part of 1949 he was unable to work because of trouble from an old foot injury, and during said disability his employer paid him, under the "Plan for Employees' Pensions, Disability Benefits and Death Benefits", the amount of $2,100.00. From this sum, his employer

withheld $318.44 and paid it to the United States as income taxes. (Record, pages 7-8.)

Gordon P. Haynes and his wife, Essie M. Haynes, filed a claim for a refund of said $318.44, which was disallowed by the Commissioner of Internal Revenue. They then filed suit in the instant case to recover said sum. (Record, page 7.)

The case was tried in the United States District Court for the Northern District of Georgia, Atlanta Division, which Court rendered an opinion and judgment in favor of the plaintiffs. (Record, pages 71-78.)

The case was carried to the Court of Appeals for the Fifth Circuit by the defendant, and was reversed. (Record, page 91.)

(b)

Basis for Federal Jurisdiction in the District Court.

Jurisdiction in the District Court, the Court of first instance, was based upon the provisions of Title 28 Federal Code Annotated, Section 1346 (a) (1) (i) (ii). (Appendix E.)

VI.

ARGUMENT AMPLIFYING THE REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

The question involved in the instant case is of great public importance. A great many of the large corporations of the United States have Plans which provide benefits similar to the Plan in the instant case. The benefits under these plans are really insurance, and are exempt from taxation. There are already cases pending which involve the employee benefit plans of:

American Telephone and Telegraph Co.
(*Herbkersman* case, Ohio)
Southwestern Bell Telephone Co.
(*Tinsley* case, Oklahoma)
(*Pietsch & Adams* cases, Texas)
Esso Standard Oil Co.
(*Oliva* case, Tax Court, Pennsylvania)
Standard Oil Co. of Kentucky
(*Branham* case, Kentucky)
Standard Oil Co. of Texas
(*Gamble* case, Texas)
Lincoln Telephone Co.
(*Cary* case, Nebraska)
Eastman Kodak Co.
(*Huse v. McGowan* case, New York)

and others. The decision in the instant case would affect thousands of employees in many businesses who received disability benefits under such a plan.

The first case to be decided by a Court of Appeals involving the question in the instant case was *Epmeier vs.*

United States, in which the Court of Appeals for the Seventh Circuit decided in favor of the taxpayer. *(199 Fed. 2d 508.)*

The second case to be decided by a Court of Appeals is the instant case in which the Court of Appeals for the Fifth Circuit decided in favor of the United States. (Record, page 91; Appendix A.)

Thus the decision in the instant case is in conflict with the decision in the *Epmeier* case, and the conflict should be resolved by this Honorable Court.

This Honorable Supreme Court has not ruled on the question involved in the instant case, but petitioners most respectfully submit that said question should be settled by this Court.

There have been District Court decisions all over the United States on this question; some courts have ruled in favor of the taxpayer, some in favor of the United States. Some of them are in the process of appeal. For the use of this Court, we list some of them below:

Case:	**Trial Court:**	**Result:**
Herbkersman (133 F.Supp. 495)	Southern District of Ohio	For Taxpayer
Adams, W. A.	Eastern District of South Carolina	For Taxpayer

Tinsley
Western District of Oklahoma
For Taxpayer

Priebe
District of Arizona
For Taxpayer

Moholy
(132 F.Supp. 32)
Northern District of California
For United States

Oliva
Tax Court of the United States (from Pennsylvania)
For United States

Branham
(136 F.Supp. 342)
Western District of Kentucky
For United States

Cary
District of Nebraska
For United States

Gamble
Southern District of Texas
For United States

There are other cases pending in other states in which no decision has been rendered at the time of preparing this petition.

PRAYER.

For the reasons herein given, Petitioners pray for a Writ of Certiorari directed to the Court of Appeals for the Fifth Circuit to the end that the judgment of that Court may be reviewed by this Court and reversed with directions that the judgment of the trial court be affirmed.

Respectfully submitted,

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Atlanta 3, Georgia,
Attorney for Petitioners.

JOHN H. HUDSON,
WILLIAM R. HUDSON,
521 Connally Building,
Atlanta 3, Georgia,
Of Counsel.

CERTIFICATE OF SERVICE.

This is to certify that I have this day served Hon. James W. Dorsey, United States Attorney, Old Post Office Building, Atlanta 3, Georgia, by ordinary mail; I have this day served the Solicitor General, Department of Justice, Washington 25, D.C. by air mail, and Hon. Harlan Pomeroy, Trial Attorney, Department of Justice, Washinton 25, D.C. by air mail; I have served each of said persons with a copy of the Petition for Writ of Certiorari and Appendix in the above stated case by depositing in the United States mail a copy of same in a properly addressed envelope with adequate postage thereon.

This 12 day of July, 1956.

Attorney for Petitioners.

APPENDIX.

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APPENDIX A.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 15655

UNITED STATES OF AMERICA,
Appellant,

versus

GORDON P. HAYNES and ESSIE M. HAYNES,
Appellees.

Appeal from the United States District Court for the Northern District of Georgia.

(April 20, 1956.)

Before BORAH, TUTTLE and BROWN, Circuit Judges.

TUTTLE, Circuit Judge: This appeal from a judgment of the district court in favor of the taxpayer raises the question whether payments made by his employer during sick leave, under the employer's disability bene-

fit plan, are exempt from taxation under the provision of Section 22(b)(5) of the Internal Revenue Code of 1939, which exempts "amounts received through . . . health insurance . . . as compensation for . . . sickness."[1]

Taxes are a creature of statute. It is thus the duty of the Court to look to the statute and if the incidence which makes the tax applicable exists, then the tax follows perforce; but if it does not exist, then it is not within the province of the Commissioner of Internal Revenue, by regulations, or the Courts, by judicial legislation, to bring something within the ambit of a tax that Congress has not placed there. This rule must, of course, work both ways. In devising a scheme of taxation Congress may well discern an area of limited dimensions in which it considers that special relief is indicated. It may then determine that carving out a special exemption will not cut so deeply into anticipated revenues as to cause the favoring of the limited class to

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[1] The applicable statute is as follows:
Internal Revenue Code of 1939:
Sec. 22. GROSS INCOME.
(b) [as amended by Secs. 113 and 127, Revenue Act of 1942, c. 619, 56 Stat. 798] Exclusions From Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
(5) Compensation for injuries or sickness.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;
(26 U.S.C.A. 1952 ed., Sec. 22.)

bear too heavily on the great bulk of the taxpayers. Congress must then be able to enact a statutory exemption for such limited area with its restricted revenue loss with the assurance that such exemption will not be broadened by judicial fiat into something covering a much larger area and involving manifold greater revenue loss.

Here Congress provided an exemption from gross income of "amounts received . . . through . . . health insurance . . . as compensation for . . . sickness." The taxpayer seeks to have included in such exemption amounts paid to the employe by the employer which in fact comes to him as a continuation of his regular salary during sick leave.

Both parties, in their briefs, discussed at length the particular terms of the voluntary plan put into effect by the employer, the Southern Bell Telephone & Telegraph Company, under which it provided pay benefits to sick or injured employes on a sliding scale, varying from full pay for four weeks, and half pay thereafter for nine weeks for an employe with from 2 to 5 years' service, up to full pay for a year for an employe, such as taxpayer, with 25 years or more. We think the details of the plan are relatively unimportant, since it cannot be disputed that there is no separate contract or agreement of insurance covering an obligation to pay any amounts to the company's employees. We think it clear that when Congress limited the exempt payments to "amounts received through health insurance" it had a concept, clearly stated, of amounts the payment of which was definitely

and with binding force fixed by an insurance contract between the employe and an insurer or between the employer and an insurer for the specific benefit of the employe.

In the trial court there was evidence to the effect that sickness and health insurance was not ordinarily written for full salary amounts; that the employer here did not make payments on an actuarial basis in relation to the amount of risk or to any other factor of age, state of health, or anything else; that no reserves were set up as is ordinarily done in the case of insurance, and that benefits were voluntarily fixed by a management committee. The importance of this evidence is not to prove that the company's plan here was unlike insurance, but it was relevant and of great weight to the proposition that when Congress exempted only such amounts as come "through health insurance," it had a clearly defined class in mind, and that this class is readily identified by normally having a bundle of attributes or characteristics associated with the term "insurance." This class of persons whose payments were exempt were those who, for a definite consideration, having an actuarial relation to the benefits provided, paid by them or on their behalf, obtained insurance coverage under ordinary insurance standards. There was thus an ascertainable amount of gross income involved, from which an estimate of loss of revenue to the government could be made. This loss would obviously be quite different from the loss that would result if the class designated by Congress was made to include every employe who received

payments of salary or wages by the voluntary action of his employer during sick leave.

Our reference to the loss of revenue is not intended to suggest that such loss has any part in enabling the Court to construe a tax statute. The government makes no such argument here and we would not consider it if made. The reference to the differing impacts upon the revenue is cited to indicate that Congress, in adopting an overall scheme of taxation in which the revenue loss of each exemption plays an important part, must choose words of description to set apart those taxpayers or payments within the exemption. In this case the term "through insurance" was the terminology adopted by Congress for this purpose.

We think it clear, without resort to any but the fundamental rule that words are ordinarily to be taken to mean what they usually import to the average person, that Congress meant to give the exemption here only to amounts received through insurance. If it had intended that all payments received as compensation for sickness were to be exempt it would, of course, not have used the words "through insurance" at all. They would clearly have been superfluous and misleading if that had been the intent of the lawmakers.

Appellee here relies on the decision of the Court of Appeals for the Seventh Circuit in *Epmeier v. U. S.* (7 Cir.), 199 F. 2d 508, by which case the trial court doubtless felt bound. Although there are present in the Epmeier case facts that might warrant our distinguish-

ing it from the case before us, we think that even those facts are unimportant in construing the statute here before us. In Epmeier the employe was working for an insurance company, a company which had the authority to issue health insurance, although no health insurance had actually been issued by it to cover the payments involved in that litigation. The nature of the employer's business was stressed by the Court, but it also construed the purpose of the statute as "to relieve a taxpayer who has the misfortune to become ill or injured, of the necessity of paying income tax upon insurance benefits received to combat the ravages of disease or accident."

With deference to the views of that distinguished Court we are of the opinion that the purpose of the statute was to exempt from income tax the proceeds of insurance which had been bought and paid for by the payment of premiums consciously and knowingly made for "health insurance." Whatever the activating motive of Congress may have been in passing the law, its intent was clear that the exemption was to apply only to payments received through insurance. The payments made to the taxpayer here by the Southern Bell Telephone & Telegraph Company during his absence on sick leave were not such payments. They had no relation to health insurance. See *Moholy v. U. S.*, 132 F. Supp. 32 (N.D.Cal.), pending on appeal C.A.9; *Branham v. U. S.*, 136 F. Supp. 342 (D.C.Ky.); and *Herbkersman v. U. S.*, 133 F. Supp. 485 (S.D.Ohio), pending on appeal C.A. 6. These cases deal with similar questions, the first two having been decided by the district court in favor of the government, the third in favor of the taxpayer.

The judgment of the trial court erroneously construed the exemption statute as covering payments which were not, in fact, received through health insurance. It must be reversed and judgment rendered for the appellant.

REVERSED and RENDERED.

BROWN, Circuit Judge, Dissenting:

Admonished as we are, and almost invariably at the behest of the Tax Collector that "Questions of taxation must be determined by viewing what was actually done * * * and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder, we must regard matters of substance and not mere form * * *," *Weiss v. Stearn*, 265 U.S. 242, 68 L.Ed. 1001; "* * * The incidence of taxation depends upon the substance of the transaction * * *," *Commissioner v. Court Holding Co.*, 324 U.S. 331, 89 L.Ed. 981, the result here is difficult to comprehend. For it is the triumph of form over substance. Form is the absolute monarch here not only in requiring *a* contract, but in specifying the type of contract, the nature of the considerations which business men must have applied, and the specific guaranties required.

To be more specific, in the Court's eye, it must be a contract of insurance, named as such, issued by one having unquestioned legal authority to underwrite, calling for the payment of premiums and specifying ascertainable, legally enforceable obligations. The Court states it several ways, but it always adds up the same:

> "We think the details of the plan are relatively unimportant, since it cannot be disputed that

> there is no separate contract or agreement of insurance covering an obligation to pay any amounts to the company's employes * * *."

And again, the Congressional concept of the phrase "amounts received through health insurance" is stated to be, "amounts the payment of which was definitely and with binding force fixed by an insurance contract between the employee and an insurer or between the employer and an insurer for the specific benefit of the employee * * *." The Congressional concept of the *type* of contract is expanded then into a concept as to the *class* of persons affected. But as to the class and as to the type, it is the *paper* which counts: "This class of persons whose payments were exempt were those who, for a definite consideration, having an actuarial relation to the benefits provided, paid by them or on their behalf, obtained insurance coverage under ordinary insurance standards * * *."

I can find no basis for these conclusions either in the inquiry concerning the intent and purpose of Congress as it acted in its dual capacity of creator and defender of the public Treasure, or in the analysis of the factors underlying the nature of insurance. On this latter phase I feel that the Government's contention, essentially adopted by the Court, suffers from two underlying defects: first, it is not for the Government to decide what free men ought to consider a fair bargain, and second, the record and contention that this arrangement lacks the qualities of insurance evidences a surprising lack of understanding of the nature of modern insurance.

As to the Congressional motivation, I accept, of course, the Court's statement that it is not entering into the field of legislative wisdom. I do not for a moment think that the Court bases its conclusion upon the prospective loss of revenue. This supposed concern of Congress is, however, put forward as a likely or probable explanation for the use of the terminology "through insurance". I am unable either to see any basis for the argument or where it gets us.

I do not know how Congress, in 1939, could keep its legislative grace "within bounds" for succeeding years by knowing then the extent to which health and accident insurance had become a part of the contemporary social-economic life. Perhaps there is the thought that the situation was automatically, albeit somewhat unconsciously and certainly informally, reviewed from session to session as Congress met, impliedly reapproved the 1939 concept, and then adjourned without amendment. But, finally, since Congress in 1939 could not possibly know the amounts which would be paid in 1949 either as insurance under contracts of insurance or as benefits under employer plans, I hardly see how the proper legislative concern with impact on probable revenues aids us at all.

When it comes to the analysis of the Telephone Company's arrangement here, I must confess that I am confused as to just what the Court does with it. After detailing briefly the supposed deficiencies as an insurance contract, the Court first states, "The importance of this evidence is not to prove that the company's plan here was unlike insurance * * *." But while disavowing such pur-

pose, apparently out of regard to the view this Court has always taken that it is not for Government to intrude itself upon the reasonableness of business agreements made between free men, it arrives at the same result, for instead of saying that the arrangement was "unlike insurance," it merely holds that the beneficiaries of this plan are not within the *class* of persons who have rights under an insurance contract; for the Court says, "* * * but it was relevant and of great weight to the proposition that when Congress exempted only such amounts as come 'through health insurance', it had a clearly defined class in mind, and that this class is readily identified by normally having a bundle of attributes or characteristics associated with the term 'insurance.' "

I would think that if the plan was sufficiently "like" insurance as to be "insurance" then the beneficiaries of the plan would be within the class of persons covered by "insurance". In this respect it seems to be another argument advanced as proof but then withdrawn.

If so, then premise and conclusion stand alike in terms: Congress said "amounts received through accident or health insurance"; therefore, Congress meant payments made under health insurance contracts.

But the exact mechanism of the Court's process of reasoning is not, in my judgment, significant because, basically, the attack made by the Government, sustained by the Court, that because of certain supposed deficiencies the arrangement lacks the *quality* of an insurance contract simply will not bear analysis.

There is, first, no magic about an insurance contract. Like any other, it is merely an agreement to pay ascertainable sums upon the happening of indicated contingencies in return for the payment of some consideration. Where the question is whether a person assuming the obligations of an insurer is engaged, or may engage, in the insurance business, as such, the problem may become more complex in determining whether such person has complied with the common and numerous statutory requirements regulating that particular business. But here the question is not whether Southern Bell Telephone and Telegraph Company may engage in the general insurance business. The question is: have they made a contract of insurance. If a contract of insurance has been made between the Telephone Company and its employees, it is not open to the Government to challenge its validity on some supposed corporate infirmity or the like. *Charlotte Union Bus Station, Inc. v. Commissioner*, 4 Cir., 209 F.2d 586; Francis M. Camp, 21 BTA 962; *J. N. Wheelock et al v. Commissioner*, 16 TC 1435. The elements of an insurance contract are few and simple.[1] The nature of the contract, the agreement to insure, is not

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[1] 44 C.J.S., Insurance:
Page 471, "*Definition*. Fundamentally it is an agreement to pay a sum on the happening of an event, and has been said to be best defined as a contract whereby one undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event. More broadly, however, the term 'insurance,' or 'insurance contract,' or 'insurance policy,' in the sense of the subject matter with which it deals, denotes a contract by which one party, for a compensation called the 'premium,' assumes particular risks of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency * * *".
See also page 477, Disability Insurance, and page 480, Health Insurance.

determined by its form or the label affixed to it; it is judged on substance.[2]

But the Court, obsessed with its conviction that the contract of insurance must be in a particular form issued by a particular company, waives all of this to one side because, "the details of the plan are relatively unimportant." The synoptic analysis set forth in Appendix I amply demonstrates that this arrangment satisfied the requirements of a contract[3] of insurance.

The attack on the plan for its intrinsic deficiencies from an insurance standpoint fares no better.

At the outset this should be recognized for what it is: it is the intrusion again of the Commissioner into the business affairs of citizens. He has the right, of course, to impose and collect the taxes incident to the per-

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[2] 29 American Jurisprudence, Insurance, §4: "The name by which a company * * *, or its certificates or policies, are designated is not determinative of the question whether * * * its contracts are in the nature of insurance policies * * *. The nature of a contract as one of insurance depends upon its contents and the true character of the contract actually entered into or issued—that is to say, whether a contract is one of insurance is to be determined by a consideration of the real character of the promise or of the act to be performed, and by a consideration of the exact nature of the agreement in the light of the occurrence, contingency, or circumstances under which the performance becomes requisite * * *."

The form is so unimportant that the contract to insure may be oral. 29 American Jurisprudence, Insurance, §§127, 129 and, generally, §126.

[3] Appendix I is taken verbatim from Taxpayer's brief and illustrates well how material may be effectively presented with graphic force and convenience to the Court.

Undoubtedly impressed by this technique the brief of Robert K. Jewett and Thomas E. Berry, Esqs., *amici curiae*, following a similar format, contains a tabular comparison of the Haynes, Epmeier and Herbkersman cases and is included as Appendix II.

formance of the contract. But he does not have the right to say what contract shall be made nor what consideration shall be followed, nor what may be considered a good bargain. He cannot do this directly, nor can he do it by the favorite administrative device of the oblique approach in which, it is urged, the transaction as the Taxpayer says it occurred, could not have occurred because such a course would have been unreasonable.

But granting the Commissioner the right to supervise contracts, to assay them from the standpoint of inherent business reasonableness or unreasonableness, to give him an over-the-shoulder gentle guidance to business transactions, his objections here are quite inadequate.

It is contended that since the plan calls for the payment of the full weekly salary for the stated periods, there is no incentive upon the part of the employee to return to work, and this stands in contrast to the ordinary commercial policy limiting weekly indemnity to 75 to 80%.[4] Likewise, it is said that since the Company, in its intracompany accounting, charged payments under the disability plan to operating expense; carried them as one of the specified items under the general category of salaries and wages rather than as plan benefits similar to the way they did for payments into the pension fund; maintained no special reserve account; payments were

[4] Just what is the source of the statements made by the Government concerning the insurance business is quite obscure. Certainly not in this record comprising as it does only the vaguest of words from a local, general agent for one private health and accident company whose testimony, on the whole, shows that he neither posed as an industry-wide expert, nor was he attempting to state the variable conditions upon which underwriters would be bound.

based on salary only not on some actuarial standards; benefits were available to all employees without a specific medical examination; and the company was not obliged to pay premiums over and above the cost of the actual weekly benefits paid kept this from being insurance. Similarly, complaint is made that the administration of the plan is finally in the hands of Company executives whose decision is stated to be final. This proves, it is claimed, that the plan is a gratuitous arrangement only with no contractual obligations and which is further borne out by the fact that no suit has ever been filed under it.

But all of these contentions ignore the real nature of the insurance business. One thing stands out in the long history of the development of insurance: it came into being out of the business necessity of hedging and protecting against contingent hazards. It is the business man then who determines in the first instance what is needed and the nature and extent of the protection sought. The underwriter lays down the terms most generally by adjusting the cost of the insurance upwards or downwards. In this way underwriters will literally insure anything. If a business, therefore, such as the Telephone Company, determined, as it in its judgment saw fit, that good business called for an insurance policy awarding weekly benefits equivalent to this plan, it is certain that it could, and would, be quickly underwritten. The fact that the required insurance called for the payment of 100% of the employees' salary instead of 75 to 80% would, if material at all, be adjusted in the rate. The same would be true concerning the supposed moral risk as payment

of the equivalent of full weekly wage is thought to destroy the incentive to return to work. The element cannot be a big one because for the first five years of employment, the full wage benefit is payable only for four weeks and, on a graduated scale, it finally works up to a maximum of fifty-two weeks after twenty-five years. An underwriter might well consider that the personnel standards of the insured company were such as to likely attract and hold conscientious people of high moral responsibility who would not be beguiled into malingering by the lure of these limited payments. The underwriter would undoubtedly take into account also the counter incentive to remain on the job to assure advancement in pay and position with its cumulative effect of increasing future disability benefits and pension and retirement advantages.

Moreover, this whole argument ignores the widespread postwar development in the field of health and accident insurance in which reliable companies are offering a variety of packaged benefits designed to help the breadwinner over periods of disability from accident or disease.

Health and accident insurance is not normally written upon a prior health examination and even the so-called expert conceded this. Nor is there any basis in the industry for the Government's contention that payments are based upon some actuarial standard. On the contrary, they invariably call for the payment of fixed weekly indemnities.

The premium cost might, in commercial insurance companies be determined on a so-called actuarial basis, but

no underwriter could hope to have a better experience upon which to calculate his premium than that of the Southern Bell Telephone Company whose plan has been in operation since 1913. This leads to the very curious argument that it cannot be insurance because it only costs the Telephone Company what it pays out, and if it were insurance, they would either pay less or pay more. We have progressed far beyond the naive idea that loss is not sustained merely because it is insured. Business knows now that ultimately it bears its own losses, so that insurance is more and more a catastrophe-stop loss and an efficient claims adjusting service. So, while for one year or so, the premium cost to the Telephone Company might be much less than the total payments made to employees, it would not be long until there was a reliable ratio between known probable income and outgo. One of the interesting manifestations of the new business point of view toward the real loss is the growth of retrospective rating plans of one kind or another. In this system the ultimate premium paid is dependent upon the particular assured's own loss experience. There are infinite variations in these plans, but in the main they call for the payment of a premium equivalent to losses plus an added arbitrary percentage for claims handling and overhead with or without, at added cost, catastrophe-stop losses. It then becomes a matter of pure business judgment whether any real purpose is to be served by the entry of an insurance company and its policy. Frequently this is required by external statutory provisions, such as Workmen's Compensation, Motortruck Carrier, Cargo and Public Liability Insurance Compulsory Automobile Insurance, or the like. But where external conditions

do not require the entry of an insurance company, it is but an ordinary business problem to determine the probable cost by self-insurance as opposed to outside insurance.

This leads naturally to another demonstration that the requirement of an insurance company contract is artificial indeed. Whatever the corporate power under Georgia Law of the Telephone Company to write insurance, it could easily have organized its own health and accident insurance affiliate. The Company would not have to worry about losses, reserves, or the like because whatever the subsidiary paid out, it would know that it would have paid the same to the employees under the plan. Likewise, being a part of a large family of integrated Telephone Companies, it could easily have organized with other company members of AT&T a mutual insurance company or a Reciprocal Exchange.

The essence of each is that the insured is also insurer. Since the exposures would be consistent and uniform, the losses ultimately would fall substantially on each participating member company. The cost then would be what it has always been.

Of course, it is a little absurd to elaborate on what must be such an obvious economic fact: if experience over the years by Southern Bell Telephone Company shows the payment of stated sums as plan benefits, it is obvious that the cost through insurance policies would have to be at least as much and likely more. There is nothing in Section 22(b)(5) to require that an employer

discard his own business judgment in appraising the alternative means of giving employees health and accident insurance benefits. Large companies frequently self-insure property and liability exposures of millions of dollars. Unless the Commissioner has the right to veto it, there is no reason why the same policy cannot be followed on a health disability plan whose risks, it must seem obvious, are slight. The criticism that there are no reserves as such, or that the plan is administered by Company executives is likewise superficial. Of course, it is the Commissioner again trying to tell the employee that the security of his "insurance" contract is no good because there is not a special reserve posted or the management may be prejudiced. But disregarding this, there is no showing that ample funds are not available or that security would better be assured by frozen funds. If one were required, the Commissioner would likely again enter the picture to determine the nature and kind of investments and perhaps might criticize an investment by the Telephone Company in its own or affiliates' stocks even though our Government follows somewhat the same practice with Social Security revenues.

That there has not been a suit for 30 years over the plan does not prove it lacks legal enforceability. And again, just what kind of a contract would satisfy the Commissioner? Suppose the employee belongs to a Fraternal lodge which issues a policy or a certificate? Suppose, as is quite common, it is his labor union that provides a specific benefit against specific premium contributions? Is it any less "amounts received through * * * insurance" if, as is so common, the bylaws of the lodge or union vest

absolute power in the officers and presumably prohibit claim or suit? Nor is there any assurance that courts would not protect these beneficiaries if, under the terms of the plan, certain weekly benefits had accrued by prior service but were arbitrarily denied by the Telephone Company.

I have discussed these contentions in some detail because I think it important that in this situation it is imperative that substance be the rule of reason.

This plan has all of the attributes of insurance. It is not necessary to satisfy the statute that the plan adhere to the underwriting principles of any one particular health and accident insurer. Viewed from the standpoint of its reasonableness as an insurable undertaking, the plan is one which would find great acceptance at a premium cost which could soon be calculated. Since it is the Telephone Company's money which will be spent in either case, it has determined in its wisdom that it is better as a business proposition for them to bear the direct and full costs of this, rather than resort to an external third party. By this means, the Telephone Company is able to transfer from the shoulders of its employees the risks of loss of essential income during periods of illness or injury. The employees have paid a valuable consideration for the risk which the employer has taken on. Their "premium" payment has been made through the services performed for the Company under the employment contract which includes, as a part, this plan.

The statute requires, of course, *insurance* payments. I would certainly agree that mere generosity on the part of an employer in continuing wages would not qualify. But where the employer's plan, carefully integrated and long maintained, makes definite provisions for the payment of specified sums over and above and beyond the wages or salary for work done, the plan and the payments under it should be treated as insurance since that is what it is in fact.

With much deference, I must, therefore, DISSENT.

APPENDIX I.

ELEMENTS OF A CONTRACT OF INSURANCE (44 C.J.S. 940)	*PROVISIONS OF PLAN IN INSTANT CASE WHICH SATISFY THE ELEMENTS OF AN INSURANCE CONTRACT:*
SUBJECT MATTER	"The Southern Bell Telephone and Telegraph Company undertakes in accordance with these Regulations, to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness or when they are retired from service, or, in the event of death, to their dependent relatives." (Pltf. Ex. 1, p. 5.)
RISK OR CONTINGENCY INSURED AGAINST	Loss of income because of employee's inability to work due to sickness. (Pltf. Ex. 1, p. 5, Sec. 1; p. 12.)
THE DURATION OF THE RISK OR CONTINGENCY	Schedule, Pltf. Ex. 1, p. 6, Sec. 6, Para. 2:— from (a) 2 to 5 years of employment—full pay 4 weeks, half pay 9 weeks to (f) 25 years or more of employment—full pay 52 weeks. Benefits begin on eighth calendar day of absence on account of disability. (Pltf. Ex. 1, p. 12, Sec. 6, Para. 3; also R/40.)

Benefits terminate when disability ceases, or period set out in Para. 2 ends. (Pltf. Ex. 1, p. 12, Sec. 6, Para. 1.)

A PROMISE TO PAY OR TO INDEMNIFY IN A FIXED OR ASCERTAINABLE AMOUNT

Schedule of amounts set out in Sec.: 6, Para. 2 of the Plan, page 12, Pltf. Ex. 1.

A PREMIUM

Services rendered by the employee:—

Epmeier vs. United States, 199 F.2d 508:

". . . . . service and labor rendered by plaintiff employee to employer was adequate consideration without payment of premium. . . . ."

Herbkersman vs. United States, 133 F. Supp. 495:

p. 496:—"While no monetary consideration is paid by the employee for the protection afforded under the Plan, the acceptance of employment with the Plan being a feature thereof constitutes a full and adequate consideration; consideration need not necessarily be a transfer of money, it may be anything of value."

C.J.S. Vol. 44, page 1323, Para. 349:

"While premiums are ordinarily payable in cash, the insurer may accept or authorize payment otherwise than in cash."

I. T. 4015, C.B., 1950-1, 23, at p. 25:

"The employees' rights to receive benefit payments under a voluntary plan in consideration of their employment and the employer's obligation to pay the benefits satisfy the requirements of contract. Furthermore, it seems clear that the contract is one of insurance, as a voluntary plan assures and promises each qualified employee a fixed compensation for a fixed period in the event accident or sickness renders him unable to work. Such assurance is the basic function of an insurance contract. Therefore, such a plan also meets the requirements of Section 22 (b) (5) of the Code."

THE PERIOD OF PAYMENT OF THE PREMIUM

Employee must work two years in order to be eligible for benefits. Pltf. Ex. 1, p. 12, Sec. 6, Para. 1; also R/22, 24.

AN AGREEMENT OF THE PARTIES ON ALL THE ESSENTIAL ELEMENTS

Plan is a part of employment contract between employer and employee.

"Each employee on entering the service of the Company will be given a copy of this pamphlet. . . . ." (Pltf. Ex. 1, p. 4.)

The following chart shows some additional elements of insurance as set out in the case of *Epmeier vs. United States*, 199 F. 2d 508:

ADDITIONAL ELEMENTS OF INSURANCE DISCUSSED IN EPMEIER CASE:	*UNDER PLAN IN INSTANT CASE:*
A SHIFTING OF THE INCIDENT OF RISK FROM ONE TO ANOTHER.	From employee to employer. Pltf. Ex. 1, p. 5, Sec. 1, Para. 1. *Herbkersman vs. United States, 133 F. Supp. 495:* "Under the Plan the employer undertakes to assume the risk which would otherwise be borne by the employee of loss of income during periods of disability resulting from sickness, and the risk is thereby transferred from the employee to the employer and this transfer of risk creates in itself a contract of insurance." (p. 496.)
"CONTRACTUAL" SECURITY	Part of contract of employment. *Epmeier vs. United States, 199 F.2d 508:*

"But we know of no reason why insurance protection must be expressed in a formal contract."

"(4) As we have indicated, we know of no reason why this insurance, when provided as part of the contract of employment between employee and employer, must follow any stereotyped or conventional form. Surely there is no legal magic in form; the essence of the arrangement must determine its legal character. We conclude that the fact that there is no formal contract of insurance is immaterial, if it clear, as here, that, for an adequate consideration, the company has agreed and has become liable to pay and has paid sickness benefits based upon a reasonable plan of protection of its employees."

C.J.S. Vol. 44, p. 1018, Insurance, Para. 249:

"No particular form of words is required to constitute a contract of insurance."

MEDICAL EXAMINATION PRIOR TO EMPLOYMENT

Not required here.

TREATMENT BY PHYSICIAN DURING DISABILITY

Pltf. Ex. 1, p. 19, Para. 11, 12:—

"(11) A disabled employee shall not be entitled to benefits if he declines to permit the Committee to make or have made by a physician, from time to time, such examination as the Committee may deem necessary in order to ascertain the employee's condition. . . . ."

"(12) Disabled employees must take proper care of themselves and have proper treatment. Benefits will be discontinued to employees who refuse or neglect to follow the recommendations of the Committee."

Epmeier vs. United States, 199 F.2d 508:

(2) . . . . ."The employee is required while ill, to follow the instructions of his physician or the company's physician, a provision closely akin to features of ordinary insurance, where the insurer is interested in avoiding extension of any resulting loss beyond that which can be reasonably avoided."

CONTRACT MAY BE REVISED

Pltf. Ex. 1, page 23, Sec. 10:

"The Committee, subject to the provisions of Section 9, with the consent of the President and subject to the approval of the Board of Directors, may from time to time make changes in the Plan set forth in these regulations, and the Company may terminate said Plan, but such changes or termination shall not affect the rights of any employee, without his consent, to any benefit or pension to which he may have previously become entitled hereunder."

Epmeier vs. United States, 199 F.2d 508:

(4). . . . ."The provision that the terms of the agreement may be changed does not impinge upon the soundness of this conclusion. Employment contracts are always subject to revision. If the terms of such changes are not satisfactory to the employee, he may terminate his service; he can not be forced to work under conditions repugnant to his sense of what is fair and proper. It is obvious also, we think, that no change could be made to defeat or lessen the liability, once it had attached. In the provisions lies the implicit agreement to pay the benefits until and unless the terms should be modified; no such

modification could reduce the liability for sickness benefits after illness had intervened."

C.J.S. Vol. 44, Insurance, para. 255, page 1031:

"Contents" . . . ."a contract of insurance is a voluntary one, and the parties thereto have a right to incorporate therein such provisions and conditions as they see fit to adopt, provided the conditions and provisions are not in violation of law or public policy."

APPENDIX II.

	HAYNES (Southern Bell Telephone & Telegraph Company Plan)	EPMEIER (Lincoln National Life Insurance Co. Plan)	HERBKERSMAN American Telephone & Telegraph Company Plan)
1. Plan stated in written document or booklet distributed to employees.	Yes.	Yes.	Yes.
2. Employee consideration found in employment services rendered—no separate contribution by employees.	Yes.	Yes.	Yes.
3. Duration of benefits based upon length of employment.	Yes.	Yes.	Yes.
4. Amount of benefits (a) based upon salary (b) equivalent to full salary.	(a) Yes. (b) Yes as applicable to Haynes—not determinable as applicable to all employees.	(a) Yes. (b) Not determinable.	(a) Yes. (b) Not determinable.
5. Applicable to all regular employees who have passed a medical examination as an incident to employment.	Yes (medical examination not required.)	Yes.	Yes (does not appear in that employees take medical examination before hired).
6. Benefits commence with first day of illness.	Generally on eighth day of illness, but first day in some cases; regular salary paid during first week and charged as sickness benefits on company records.	Inferable but not definitely determinable.	No payments made for first seven days of absence.
7. Employee while ill required to follow instructions of his or company physician.	Yes.	Yes.	Interably yes since confirmation of illness by own or company physician required.
8. No benefits for illness or injury due to alcohol, immoralities, brawling, etc.	Not determinable.	Not determinable.	Not determinable.
9. Administration of plan	Committee of 5 appointed by directors from heads of operating departments approves payments.	Office Administration Department. Right to cancel if fullest cooperation not given.	Not determinable.
10. Plan benefits and salary in single check.	Yes.	Not determinable.	Yes, if absence occurs in same pay period as regular payment for actual service.
11. Costs of benefits not determinable under actuarial tables, and no funded reserve.	Yes.	Not determinable.	Not determinable.
12. Plan subject to termination not to affect rights accrued prior thereto.	Yes.	Yes.	Yes.

A True Copy:
Teste:

(Seal)

JOHN A. FEEHAN, JR.,
Clerk of the United States Court of Appeals for the Fifth Circuit.

APPENDIX B.

JUDGMENT.

Extract from the Minutes of April 20, 1956.

No. 15655.

UNITED STATES OF AMERICA,

versus

GORDON P. HAYNES and ESSIE M. HAYNES.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and judgment here rendered for appellant, United States of America.

"BROWN, Circuit Judge, dissenting."

APPENDIX C.

Title 28, Federal Code Annotated, Section 1254: Courts of appeals; certiorari:

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

APPENDIX D.

Internal Revenue Code, Title 26, Sec. 22 (b):

(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter (Sec. 1 to 476 of this title):

. . . . . .

(5) Compensation for injuries or sickness. — Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

. . . . . .

APPENDIX E.

Title 28, Federal Code Annotated, Section 1346. United States as defendant. — (a) The district courts shall have original jurisdiction, concurrent with the Court of Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws, (i) if the claim does not exceed $10,000 or (ii) even if the claim exceeds $10,000 if the collector of internal revenue by whom such tax, penalty or sum was collected is dead or is not in office as collector of internal revenue when such action is commenced;

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Supreme Court of the United States

OCTOBER TERM, A.D. 1956.

No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

BRIEF ON BEHALF OF PETITIONERS.

JOHN H. HUDSON,
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521 Mark Building,
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SUPREME COURT OF THE UNITED STATES.
OCTOBER TERM, A.D. 1956.

No. 257.

GORDON P. HAYNES AND ESSIE M. HAYNES,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

BRIEF ON BEHALF OF PETITIONERS.

I.

OPINIONS OF THE COURT BELOW.

(1) DISTRICT COURT: *Gordon P. Haynes and Essie M. Haynes vs. United States of America*, 139 F. Supp. 671.

(2) CIRCUIT COURT: *United States of America vs. Gordon P. Haynes and Essie M. Haynes*, 233 Fed. 2d 413.

II.

STATEMENT OF GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

Date of Judgment to be Reviewed: April 20, 1956. (R. 125.)

Statutory provision believed to confer on this Court jurisdiction to review the judgment in question: 28 U. S. C. A. Sec. 1254 (1). (Appendix A; page 23 of this Brief.)

III.

STATUTE INVOLVED.

The statute involved is: Internal Revenue Code of 1939, Section 22 (b) (5) (26 U.S.C.A. Sec. 22 (b) (5). (Appendix B, page 23 of this Brief).

IV.

THE QUESTION PRESENTED FOR REVIEW.

The question for decision is:—Whether amounts paid to the taxpayer in 1949 by his employer during sick leave and pursuant to his employer's disability benefit plan are exempt from taxation as amounts received through health insurance within the terms of Section 22 (b) (5) of the Internal Revenue Code of 1939.

The District Judge held that they were. (R. 52-53.)

The Court of Appeals held that they were not. (R. 107.)

V.

STATEMENT OF THE CASE.

This action was brought in the United States District Court for the Northern District of Georgia, Atlanta Division, by plaintiffs, to recover the sum of $318.44 which they allege was illegally collected from them. Jurisdiction was invoked under the provisions of 28 U.S.C.A. Sec. 1346 (a) (1). (R. 1.)

Plaintiffs contend that $2,100.00 paid to plaintiff, Gordon P. Haynes, by the Southern Bell Telephone and Telegraph Company was sickness benefits, and as such was exempt from taxation under Title 26, U.S.C.A. Sec. 22 (b) (5). Plaintiffs contend that their timely claim for a refund was disallowed by the Commissioner of Internal Revenue and that they were so notified on June 2, 1954. (R. 1-2.)

Defendant denies that during 1949 plaintiffs paid to Marion H. Allen, Collector of Internal Revenue for Georgia, by means of withholding tax, $318.44 representing income tax on the sum of $2,100.00 paid to plaintiff, Gordon P. Haynes, as sickness disability benefits for the year 1949 by the Southern Bell Telephone and Telegraph Company, but admits that plaintiffs paid $723.84 in income tax liability for the year 1949. (R. 3.)

Defendant admits that plaintiffs filed a claim for refund and that the same has been disallowed by the Commissioner of Internal Revenue and that plaintiffs have

been so notified, but denies that said tax was erroneously assessed or illegally collected. (R. 3.)

The plaintiff, Gordon P. Haynes, in 1949 had been employed by the Southern Bell Telephone and Telegraph Company, hereinafter referred to as "the company" for more than 25 years and in that year he became sick (R. 7-8) and was paid in sick disability benefits under the Plan hereinafter described, the sum of $2,100.00 from which the company withheld the sum of $318.44 for income taxes on such sum and the $318.44 was paid by the company to the Collector of Internal Revenue. (R. 5-6.) The plaintiffs filed a claim for refund alleging that such amount was improperly withheld and this claim for refund was thereafter rejected by the Commissioner of Internal Revenue and the present action was instituted by plaintiffs to recover the $318.44 and the interest. (R. 8.)

In 1913 the company inaugurated a "Plan for Employees' Pension, Disability Benefits and Death Benefits" which plan, with amendments, is still in force and effect. (Pl. Ex. 1, R. 5, 56.) Under this plan the company "undertakes to provide for the payment of definite amounts to its employees when they are disabled by accident or sickness, or when they are retired from service, or, in the event of death, to their dependent relatives." (Pl. Ex. 1, R. 5, 62.) The plan provides, *inter alia*, for sickness disability benefits to all employees of more than two years service with the company and the payments generally begin upon the eighth day of absence from work (Pl. Ex. 1, R. 5, 72), but when an employee has received benefits and is absent on account of illness within two weeks of the ter-

mination of benefits, the payments begin as of the first day of absence. (Pl. Ex. 1, R. 5, 73.) The amounts paid and the length of time over which the payments are made are governed under the plan by the length of service of the employee with the company and under such provisions of the plan an employee, such as plaintiff here, who had a term of employment with the company of 25 years, or more, may receive as sickness disability payments full pay for a total period of 52 weeks. (Pl. Ex. 1, R. 5, 72.)

Under the plan sickness disability benefits are not payable during a period of lay-off (Pl. Ex. 1, R. 5, 81), and no employee has a right to such benefits after his discharge. (Pl. Ex. 1, R. 5, 79.) The plan is subject to change and may be terminated, but such termination can not affect rights to which an employee had become entitled prior to such termination. (Pl. Ex. 1, R. 5, 79.)

The plan is administered by a general committee of five members who are appointed and serve during the pleasure of the board of directors of the company and the committee is responsible to the board and the president of the company. (Pl. Ex. 1, R. 5, 63.) The members of such committee are appointed from the operating heads of the various departments of the company and the majority of their time is devoted to company affairs and not over three hours a week is devoted by the members of the committee to committee work. (R. 11-12.)

All employees, regardless of his or her salary, except those who have worked less than two years with the

company, are covered by the plan (Pl. Ex. 1, R. 5, 72), and they are not required to take a physical examination or to make application in order to receive benefits under the plan. (R. 23.) The plan only covers employees of the company (R. 14) and no contribution of cash or other thing of value is required or made by employees in order to be covered by the plan and to receive benefits thereunder, except services rendered by the employees in their employment. (R. 15.)

Employees receive their regular pay during the first week of absence on account of illness and subsequent weeks are paid under the plan, (R. 15), and all such payments, under the Plan are listed on the company's records as sickness benefits. (R. 17.) In case of absence of an employee for sickness, the sickness disability payments to such employee are authorized by the secretary of the committee subject to later approval or ratification by the committee and the committee is authorized by the board of directors to approve payments to employees in excess of those provided for in the plan, and such payments are made in needy cases. (R. 14-16.) The committee also has authority to and make loans to employees from time to time (R. 18-19), and has authority to deviate from the plan in other respects. Since the inception of the plan the company has never been sued for sickness disability benefits thereunder. (R. 18.)

The company maintains no fund from which disability payments are made and all of such payments are charged to operating expenses. (R. 16.) There is no trust or as-

sociation which administers the disability benefits under the plan other than the Committee, and no reserve is set up on the books of the company against which disability payments are charged: (R. 16-17.) There is no insurance reserve (R. 17) and unlike payments to the pension fund under the plan, the cost of sickness benefits is not determined by contributions on an actuarial basis. (R. 18.) Payment to an employee for time actually worked and for sickness benefits in a single bi-weekly pay period is generally in a single check, (R. 25), and in cases where an employee works part of a day and is entitled to sickness disability benefits for the remainder of the day, the entire amount paid to him for that day is charged to his regular salary account. (R. 17.) Approximately 2% of the company's payroll in 1949, the year involved here, comprised sickness disability benefit (R. 18) and a total of $1,700,000.00 was paid as such benefits under the plan in that year. (Df. Ex. 1, R. 12, 89.)

The company is not licensed by the State of Georgia to engage in the business of health insurance. (Df. Ex. 7, R. 44, 102.)

Private insurance companies who write health insurance do not usually insure a person for more than 80% of the salary earned by such person, and in group health insurance the limitation is approximately 2/3 of the salary earned, the reason for this being to provide incentive for the insured to return to work as soon as possible, (R. 38-39), and it is not the practice of such companies to issue policies where the period of time during which benefits are to be paid depends upon the length of time the person has held a particular job or position. (R. 41-42.)

The case was tried in the United States District Court for the Northern District of Georgia, Atlanta Division, which Court rendered an opinion and judgment in favor of the plaintiffs. (R. 48-53.)

The case was carried to the Court of Appeals for the Fifth Circuit by the defendant, and was reversed. (R. 103-107.)

VI.

SUMMARY OF ARGUMENT.

If the payments made to the taxpayer while he was unable to work had been made under the provisions of a commercial health insurance policy written by a company which was in the insurance business, there would admittedly have been no question about whether or not such payments were subject to taxation:—they would *not* have been subject.

Therefore, the question is:—Whether or not the employer's "Plan" in the instant case is "insurance", so as to bring the payments under it within the exemption set out in Section 22 (b) (5) of the Internal Revenue Code of 1939.

These four facts are clear and basic:

(1) The employee in this case was not entitled to the monies he received while away from work due to sickness except through the provisions of the "Plan", which constituted a contract between employer and employee

for the employer to assume the risk of the employee's loss of income due to sickness.

(2) The Employer had a right to protect its employees from loss of income in case of sickness. It could have done this by taking out a policy with a commercial insurance company or it could self-insure the risk, as it did here, and as in the case of Workmen's Compensation under direct statutory authority.

(3) The Company's self-insured "Plan" has all of the attributes of a contract of insurance.

(4) Whether the Company purchased a policy to cover this risk or self-insured against it is a difference without substance.

VII.

ARGUMENT.

The "Plan" in the Instant Case is a Contract of Insurance.

A contract, whereby one party, for an adequate consideration, undertakes to indemnify another against loss arising from certain specified contingencies, is an arrangement dating from ancient times. The fact that we now call this sort of contract "insurance" does not change the fundamental characteristics of it; nor does the fact that, in the interest of saving time in our rapidly-moving world, the usual provisions of such a contract are pre-printed in a form known as an "insurance policy" limit all such indemnity agreements to this pre-printed form.

Such an arrangement is still a contract of indemnity, in whatever form it may appear.

The primary essential of a contract of insurance is the presence of a risk of loss. The transfer of that risk is essentially the subject of the contract by which the insurer, in return for a consideration paid him by the insured, assumes this risk. When such a risk is assumed by one of the parties to the contract, whatever form the contract may take, it is in fact a contract of insurance.[1]

The agreement between the Southern Bell Telephone and Telegraph Company and its employees, called the "Plan for Employees' Pensions, Disability Benefits and Death Benefits" is such a contract of indemnity, and is as much entitled to be called "insurance" as any other indemnity contract.

Basically, a contract is an agreement which creates an obligation. Its essentials are competent parties, subject matter, a legal consideration, mutuality of agreement, and mutuality of obligation.[2] The Southern Bell Telephone and Telegraph Company and Gordon P. Haynes, petitioner herein, were certainly parties competent to contract. The subject matter of the contract was: pensions, disability benefits, and death benefits of employees. The consideration was the service and labor rendered by the employee to the employer, as well as the increased efficiency of the employee resulting from a better morale.[3] The knowledge

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[1] Cooley, Briefs on Insurance, p. 7, Second Edition, 1927.
See also: 44 C.J.S. p. 471, "Insurance".
Old Colony Trust Co. vs. Commissioner of Internal Revenue, 102 F. 2d 380;
Epmeier vs. United States, 199 F. 2d 508.

[2] 17 C.J.S. p. 310, "Contracts".

[3] *Epmeier vs. United States*, *supra*.
Adams vs. Pitts, 140 F. Supp. 618.

on the part of the employee that the company for which he worked had his welfare in mind and would pay him disability benefits when he was sick and unable to work, would give him a sense of security and confidence in his employer, and thereby would tend to increase his morale and cause him to work harder. The additional knowledge that the longer he worked for the company the larger his disability benefits and other benefits would be, might constitute a large factor in any contemplated change of employment, and would reduce the turn-over of employees which is one of the big problems of large companies today.

The Plan was an undertaking on the part of the Employer, a copy of which was given to each employee on entering the service of the company. (Pl. Ex. 1, R. 5, 61.) The employee was obligated to work for the company in order to be eligible for benefits, and the company was obligated to pay the benefits for which the employee became eligible. The Plan is certainly a valid and binding contract. It is true that no suit has ever been brought to enforce the payment of benefits under the Plan, but this fact merely indicates that the company has recognized and discharged its obligation under the contract without having to be compelled by the Courts to do so.

One of the most generally accepted definitions of insurance is that given in a Massachusetts case, in which the court says that a contract of insurance is an agreement by which one party, for a consideration, promises to make a certain payment of money upon the destruction of or injury to, something in which the other party has

an interest; that in fire and marine insurance, the thing insured is property; that in life or accident insurance, it is the life or health of a person; but that, in either case, neither the times and amounts of payment by the insured, nor the mode of ascertaining or securing the payment of the sum to be paid by the insurer, affect the question of whether the agreement between them is a contract of insurance, the only requisite to constitute such a contract being the payment of the consideration by the one and the promise of the other to pay the amount of insurance upon the happening of injury to the subject, by a contingency contemplated in the contract. The definition of insurance as stated in this decision has been approved in other cases and was adopted by the *Massachusetts Insurance Act of 1887, 63 ALR 713,* citing *Commonwealth v. Wetherbee* (1870), *105 Mass. 149.*

The Amount Paid to the Taxpayer During Illness was Compensation for SICKNESS, not Compensation for Services.

The money paid to the taxpayer in 1949 during illness could not be salary or wages, because wages are paid to an employee for work done, at the end of each two weeks or work (R. 9), and were paid for work actually done for the employer, and were paid for the time the employee was actually at work. Disability benefits were paid while the employee was not at work; the Plan specifically provides: "Employees shall not be entitled to receive sickness disability benefits for time for which any wages are paid them by the Company." (Pl. Ex. 1, R. 5, 73.)

The disability payments are not always the same amount of money which the employee would have earned in wages if he had been working. It is only after the employee has been with the Company 25 years that he is entitled to benefits of an amount equal to his wages. (Pl. Ex. 1, R. 5, 72.)

The government has confused compensation for *sickness* with compensation for *services*. The benefits paid in the instant case were paid because Mr. Haynes was *sick* and unable to *work* and earn *wages*. His sickness benefits were equal in amount to his wages because he had been working for the Southern Bell for more than 25 years. (R. 7.)

It is necessary, in setting up an insurance plan, to establish some basis to govern the amount of benefit payments and the length of time the payments are to be made. Individuals, in purchasing health insurance, try to buy enough to insure that the payments which they would receive in case of disability are sufficient for their needs. In practice, this amounts to figuring how much of their usual weekly or monthly wages they would have to have in order to keep their family going, and then in purchasing enough health or disability insurance to cover that amount. Since the risk insured against in all health insurance policies is loss of income during disability, the amount of the payments should bear some relation to the wages which the employee would earn if he was working. The Southern Bell has established a basis of the length of time an employee had worked for them, and the amount of his wages or salary at the time he became sick,

in determining the amount of disability benefits he would be entitled to.

It seems to us that the fact that Mr. Haynes had worked for the company long enough to draw disability benefits equal to the amount of his wages, has overshadowed the fact that under the Plan if he had been employed by the company for only five years, he would have been entitled to disability benefits, of full pay for 13 weeks and half pay for 13 weeks, and that is all, even if he was disabled for 52 weeks. (Pl. Ex. 1, R. 5, 72.) If he had been working for the company for less than two years, he would not have been entitled to any disability benefits at all. It certainly cannot be argued that this is the equivalent of wages.

We would like to call the Court's attention in this connection to the fact that, before the first witness was called on the trial of the instant case, Counsel for the Government stated that the Government was prepared to agree that some twenty-one hundred dollars was paid to the taxpayer in this case pursuant to the plan and received by him as sickness disability benefits under the Plan, and the Trial Court held this to be so stipulated by the parties to the case. (R. 6.)

Service and Labor Rendered by the Employee, as Well as the Increased Efficiency of the Employee, was Adequate Consideration to Render the "Plan" a Contract of Insurance.

While premiums are ordinarily payable in cash, the insurer may accept or authorize payment otherwise than in cash.[4]

[4] 44 C.J.S. p. 1323, para. 349, "Method of Payment in General".

Consideration for a contract of insurance is not confined to cash payment. It may be anything of value which may be acceptable to the insurer. In the instant case the service and labor rendered by the employee, and the increased efficiency resulting from a better morale, was adequate consideration to render the Plan "insurance".[5]

Internal Arrangements of Insurance Companies, to Insure that they make a Profit on the Insurance Business, should not be used as Criteria for Determining Whether "Plan" is Health Insurance.

It is conceded that there is no special fund set up by the company from which the disability benefit payments are made, except the General Expense fund, that no reserve is set up on the company's books against which payments are charged, and that the cost of the sickness benefits is not determined on an actuarial basis. These are internal arrangements of companies which are in the business of writing health insurance policies. These companies are in the insurance business for the purpose of making money, and they set up reserve funds and determine the cost of sickness benefits on an actuarial basis, in order to guard against loss of their profit. The fact that the Southern Bell does not handle the technical details of the Plan in the same way an insurance company does, is no reason to hold that the Plan is not insurance. The purpose of the Southern Bell in establishing the Plan was to look after the welfare of its employees, not to make a profit on the arrangement for payment of benefits.

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[5] *Epmeier v. United States, supra.*

The fact that insurance companies may not insure for more than 80% of a person's salary is no reason to say that Southern Bell's Plan is not insurance; nor is it essential that Southern Bell should adopt the policies and cash rates of regular insurance companies.

There is little doubt that Southern Bell could arrange with an insurance company to underwrite the Plan, even to the extent of paying 100% of the employees' salary. The insurance company would merely raise the cost of the insurance to cover the difference. Underwriters will literally insure anything, if you pay what they charge. Their principal concern is to make a profit, and so their rates will be adjusted upwards or downwards to protect them against loss. The company in the instant case probably found that it could provide greater benefits for its employees at a lower cost to the company by self-insuring the plan rather than purchasing a policy from an insurance company to cover this risk.

It is Immaterial that the Southern Bell is not Licensed by the State of Georgia to Engage in the Business of Health Insurance.

This is immaterial, since, in fact, it does insure its employees. The Southern Bell Telephone and Telegraph Company has for many years been officially approved as a self-insurer by the Georgia Workmen's Compensation Board, and while this approval specifically covers the Workmen's Compensation Insurance, it does not specifically exclude sickness benefits.

The legal authority of the Southern Bell Telephone and Telegraph Company to write a contract of insurance is not in question here. The question is:—what is the nature of the contract the company has entered into, and what is the nature of the liability thereunder which it has recognized and paid? It is established law that in proceedings involving federal income taxes the substantive nature of transactions which are fully executed and recognized by all parties in privity therewith may not be attached on the ground of non-enforceability of, or non-compliance with, regulatory provisions of state law. Thus, in the case of *Charlotte Union Bus Station, Inc. vs. Commissioner, 209 F. 2d 586 (CA-4, 1954)*, in reversing the holding of the Tax Court *(19 T.C. 336)*, it was stated as follows:

> ". . . it is elementary that only the parties to a contract may invoke the statute of frauds in respect thereto . . . There is no basis in law or in reason for permitting the government, in order to tax non-existent income, to invoke the statute of frauds and repudiate, on the basis of the statute, contracts which a taxpayer has made in good faith and under which he has surrendered the right to receive the income which it is proposed to tax."

Similarly, in *Francis M. Camp, 21 BTA 962*, and *J. N. Wheelock, et al. vs. Commissioner, 16 T.C. 1435*, where the interest of the taxpayers in the property from which the income was derived was based upon agreements, it was held that the Commissioner, for lack of privity, could not question the title of the taxpayers under the statute of frauds. Here the employer has recognized and

discharged its liability under its contract. The United States may not defeat the employee's suit on grounds which it has neither the privity to urge nor statutory authority to attack. The contract speaks for itself. It and the action of the parties thereunder are the grist for this Court's decision.

It is inherent in the powers of a corporation and its management that they may elect to assume any risks relating to the business and the advancement of the business and welfare of the employees. As a very simple illustration of this, many corporations self-insure liability, fire and many other risks. That a corporation also may self-insure the risk of loss of earnings of its employees in times of disability is but another illustration.

Public service corporations, of which Southern Bell is one, have implied power to establish sickness and accident plans for the insurance of their employees.[6] The erection of a hospital for the care of sick employees is a proper exercise of implied corporate powers.[7]

The "Plan" in the Instant Case has all the Fundamental Characteristics of Health Insurance.

The Plan in this case is a separate document, embodied in a printed pamphlet, a copy of which is given to each employee on entering the service of the company. (Pl. Ex.

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[6] *Harrison vs. Alabama Midland Ry. Co.*, 40 So. 394, 396.
Bedford Belt Ry. Co. vs. McDonald, 46 N.E. 1022, 1023.
Main vs. Chicago, B. & Q. Ry. Co., 70 N.W. 630, 632.
Chicago, B. & Q. Ry. Co. vs. Bell, 62 N.W. 314, 317.

[7] *People ex rel Metropolitan Life Ins. Co. vs. Hotchkiss*, 120 N. Y. Supp. 649, 651.
State vs. Pittsburg, C.C. & St. L. Ry. Co., 67 N.E. 93, 99.

1, R. 5, 61.) It is a part of the employment contract between the company and the employee.

The subject matter of the Plan is compensation to be paid to the employee by the company during periods of disability from accident or sickness, and other benefits. (Pl. Ex. 1, R. 5, 62.)

The risk or contingency insured against is loss of income by the employee during periods of disability due to sickness, with consequent inability to work and earn wages.

The Plan is a contract whereby this risk is shifted from the employee to the company.

After the employee has worked for the company two years, he then becomes entitled to benefits, which are payable as set out in a graduated schedule in the Plan. The payments begin on the eighth calendar day of absence on account of disability, and terminate when the disability ceases or when the period set out in the schedule ends. (Pl. Ex. 1, R. 5, 72.)

The company promises to make the payments set out in the schedule to its employees who are eligible for them, as long as the employees work for the company. The service and labor rendered by the employee to the company, and his increased efficiency due to better morale, has been held to be a sufficient consideration to render the plan a contract of insurance, without payment of any cash premium.[8]

During disability, the employee must have such examinations by a physician as the Committee shall deem

[8] *Epmeier vs. United States, supra.*

necessarily, and must take proper care of himself and have proper treatment. (Pl. Ex. 1, R. 5, 82.)

A claim for disability benefits must be filed within sixty days from the first day of absence on account of sickness, in order to be valid. (Pl. Ex. 1, R. 5, 81-82.)*

In Interpreting Income Tax Statutes, the Courts Look to the Substance of the Transaction Rather than to its Form.

It is a well settled rule of tax law that the substance of transactions will prevail over form.[9]

There is no legal magic in form. The essence of the arrangement must determine its legal character.[10] The name by which the contract is called is not determinative of the question whether it is one of insurance. The nature of the contract depends upon its contents and the true character of the contract actually entered into—that is to say, whether a contract is one of insurance is to be determined by a consideration of the real character of the promise or of the act to be performed, and by a consideration of the exact nature of the agreement in the light of the occurrence, contingency, or circumstances under which the performance becomes requisite.[11]

Time after time, in litigation over income taxes, the government, with remarkable success, has maintained that the Income Tax Law should be construed realistical-

* This subject is set out in the Appendix I of the dissenting opinion of Judge Brown, beginning on page 17 of the Record, but the arrangement of the items by the printer is confusing. We respectfully refer this Court to pages 29 through 36 of the Petition for Certiorari in this case, for a clear statement.

[9] *Weiss vs. Stern*, 265 U.S. 242, 68 L. Ed. 1001.
Commissioner vs. Court Holding Co., 324 U.S. 331, 89 L.Ed. 981.

[10] *Epmeier vs. United States, supra.*

[11] 29 American Jurisprudence, Para. 4.

ly. "Substance, not form" has been its argument. Now, the shoe is on the other foot, and the government wishes to choose form in preference to substance.[12]

The fact that the Government may have to refund some $6,600,000.00 in claims if this Court holds that the funds in this case are exempt from taxation, as pointed out in the Government's Memorandum in this case, is no argument for sustaining the decision of the Court of Appeals for the Fifth Circuit. If, as we contend, the tax on these funds was collected without authority, then the Government was not entitled to it in the first instance, and would only be refunding money which it collected illegally, therefore no loss to the government.

CONCLUSION.

Under all the facts and the law set out in the foregoing brief, and argument, petitioners believe that they are entitled to a judgment holding that said funds are non-taxable, and that the decision of the United States Court of Appeals for the Fifth Circuit, holding that said funds are taxable, is erroneous and should be reversed.

Respectfully submitted,

John H. Hudson & Wm. R. Hudson

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WILLIAM R. HUDSON,
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521 Mark Building,
98 Alabama Street, S.W.
Atlanta 3, Georgia.

---

[12] *Adams vs. Pitts, supra.*

CERTIFICATE OF SERVICE.

This is to certify that I have served a copy of the Brief on behalf of petitioners on the following persons, by depositing in the United States mail a copy of said Brief in a properly addressed envelope with adequate postage thereon, as indicated below:

1. Hon. James W. Dorsey, United States Attorney, Old Post Office Building, Atlanta 3, Georgia, by ordinary mail;

2. The Solicitor General, Department of Justice, Washington 25, D. C., by air mail;

3. Hon. Harlan Pomery, Trial Attorney, Department of Justice, Washington 25, D. C., by air mail.

This 21 day of January, 1957.

John H. Hudson
Wm. R. Hudson
Attorney for Petitioners.

APPENDIX A.

TITLE 28, U.S.C.A., Section 1254: Courts of Appeals; certiorari; . . . . Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree; . . . . .

APPENDIX B.

INTERNAL REVENUE CODE, Title 26, Sec. 22 (b):

(b) Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter (Sec. 1 to 476 of this Title):

. . . . . .

(5) Compensation for injuries or sickness.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23 (x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

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No. 257

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1956

GORDON P. HAYNES AND ESSIE M. HAYNES,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

REPLY BRIEF ON BEHALF OF PETITIONERS.

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ARGUMENT.

I.

Labeling of Payments Here Involved as "Wage Continuation" or "Sick Leave" Payments Is Inappropriate and Confuses the Issue Presented.

In its brief the Government repeatedly refers to the payments involved in this case as constituting a continuation of the taxpayer's regular salary or as "sick leave" payments. Similarly the employer's disability benefit plan, pursuant to which such payments were made, is referred to as a "wage continuation" or "sick leave" plan. Having thus categorized the plan and payments involved, the Government devotes a substantial portion of its argument to the general contention that sick leave

and wage continuation plans do not constitute "health insurance" within the meaning of the applicable statute, and that amounts paid to employees thereunder are compensation for services rather than compensation for sickness.

Such an approach unduly broadens and confuses the issue actually presented. The terms "wage continuation plan" and "sick leave plan" have no statutory significance. The Government is thus free to use them in as broad a sense as it may see fit and to include within their scope any arrangement under which payments are made to an employee during a period of illness, irrespective of its nature. But the terms as so used are of no assistance in resolving the issue in the present case. The taxpayer's position does not rest on any broad contention that all such payments are within the statutory exclusion from income.

An employer might follow the personnel practice of making payments to employees during illness, exercising its discretion in individual cases as to whether such payments shall be made and the amount thereof. Clearly this type of arrangement would not constitute "health insurance", the necessary contractual element being lacking. An employee plan might provide for an annual period of "sick leave", with continuation of wages, which may be taken irrespective of whether an employee is actually ill, so that the sick leave is really an additional period of annual leave or vacation with pay. In such a situation the payments would presumably constitute taxable compensation for services. Various statutory provisions for disability and sickness payments to governmental employees present special problems in connection with the application of the exemption, in view of their statutory rather than contrac-

tual basis, and the discretion which is usually involved as to the making of payments thereunder.*

The variety of arrangements and circumstances under which payments may be made to employees on account of sickness is very great. Obviously all such payments do not constitute amounts received as compensation for illness under health insurance within the meaning of the statute. It is equally obvious that a decision to the effect that the payments here involved are within the exemption does not require any such broad and sweeping ruling. In this case it is stipulated that the payments were made to taxpayer, as a result of his illness, under his employer's "Plan for Pensions, Disability and Death Benefits" (R. 8). The terms of the plan and the manner of its administration with respect to the payment of sickness benefits appear from the record. The question here presented is whether *this* disability benefit plan, under which the employer obligates itself to compensate its employees for loss resulting from inability to work on account of sickness on the basis of a detailed indemnity schedule, constitutes "health insurance" within the meaning of the statute. The taxpayer is not seeking tax exemption for a mere wage continuation during sick leave; to so describe the payments here involved is to assume the result for which the Government contends.

---

* Under the "sick leave plan" of the Federal Government, referred to on page 19 of the Government's brief, "sick leave" is granted as an extension of "annual leave" which a department head may allow up to a maximum of thirty days per year. Such an extension of the annual leave may be allowed under specified circumstances where the illness involved is not that of the employee but of a member of his immediate family. Where the "sick leave" is on account of the employee's own illness, it is based on a determination, necessarily involving considerable discretion, that an "exceptional and meritorious" case exists, and that denial of the leave "would work a peculiar hardship".

II.

Payments to Taxpayer Constituted Compensation for Illness, Not Taxable Compensation for Services.

Any sickness benefit plan under which an employer obligates itself to indemnify its employees against loss of earnings resulting from illness may be classified in the category of fringe benefits. Under any such plan, a valuable right is received by the employees, over and above their regular compensation, in consideration of the services rendered by them. It does not follow from this, however, that the payments made to an employee who becomes ill are taxable compensation for services rendered. It is the insurance protection which is received by him in consideration for his services. The benefit payments result from the occurrence of the loss against which he is indemnified.

This case does not involve the question whether the value of the insurance protection received by all employees under a privately insured plan such as this constitutes taxable compensation. Under the law as it existed when this case arose, the value of such insurance protection afforded under individual commercial insurance policies was taxed to the covered employee, such value being measured by the premium paid therefor by the employer. On the other hand, the value of insurance protection provided through commercial group insurance policies was administratively exempt from taxation, apparently because of the difficulty involved in determining such value. (See letter of Deputy Commissioner T. Mooney, August 26, 1943, P-H 1943 Fed. Tax Serv. ¶66,294.) A similar problem would exist in the case of a self-insured plan.

But if any taxable income is to be found in the present situation, it is the *value of the protection,* which is received by all employees. Those employees, such as the taxpayer, who collect sickness benefits are not being compensated for further services but are simply realizing upon their insurance rights. It is their sickness, not their services, which brings the benefits to them and not to the others.

The Government concedes that sickness benefits paid under commercially insured employee disability plans are exempt from taxation under the statute here involved (Govt. Br. 26, n. 14). Yet such payments are no more, and no less, in the nature of compensation for services rendered than are those under a similar privately insured disability benefit plan.

III.

A Congressional Intent to Limit "Health Insurance" to Commercially Insured Sickness Benefit Plans Cannot Be Established and Should Not Be Assumed.

The Government contends that the term "health insurance" as used in the statute was intended to refer only to conventional insurance. By "conventional" insurance it appears to mean *commercial* insurance or at least insurance which conforms very closely to the practices followed by commercial insurance companies.

Clearly, as pointed out in taxpayer's original brief, the word "insurance" as commonly understood has no such restricted meaning. While the Government asserts that the contrary is true, it cites no authority whatever in support of such assertion, and its specific argument for such narrow construction is based solely on inferences which it attempts to draw from the meager statutory history.

In this connection, reference is made to language used in the report of the House Ways and Means Committee, in discussing the provisions of the Revenue Act of 1918 from which the pertinent statute is derived, to the effect that under the existing law it was doubtful whether amounts received under accident or health insurance, or under workmen's compensation acts, as compensation for personal injuries or sickness, and damages received on account of such injuries or sickness, were required to be included in gross income. The Government also refers to prior rulings by the Treasury Department and the Attorney General to the effect that proceeds of accident insurance policies do not constitute taxable income, but these rulings are not mentioned in the aforesaid Committee report (Br. 15, 16). The comment of the House Ways and Means Committee, considered in light of these prior rulings, is said to imply that the statutory provision in question was designed to exempt only proceeds received under conventional modes of insurance (i.e., commercial insurance policies).

How such an inference arises is not apparent. The circumstance that such prior rulings happened to deal specifically with accident insurance policies no more indicates a Congressional intent to exclude payments under employer self-insured health insurance plans than it indicates an intent to exclude any of the various other types of payments covered by the statute which were not dealt with in such rulings. That the then current attitude of the Treasury Department did not make the distinction for which the Government now contends is apparent from its letter ruling of December 24, 1918, to American Telephone and Telegraph Company, a copy of which is incorporated in this brief as an appendix, and in which it was ruled that amounts received by an employee from a benefit fund,

representing payments on account of death, sickness or injury, were not income.* Congress mentioned none of these rulings, but if it acted in light of any, it is just as likely that it considered the problem in the A. T. & T. ruling in connection with the legislation as the problem in the rulings cited by the Government.

It is likewise argued that the addition to the statute involved, by the Revenue Act of 1942, of express language exempting "amounts received as a pension, annuity or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country" indicates that the original language did not include all types of employer "sick leave" plans (Br. 18). Of course, as is hereinabove pointed out, petitioners make no contention that all types of plans are exempt. The amendment in question was enacted in time of war, after the draft had been put into effect, and in circumstances where a highly specialized situation existed with which Congress thought it well to deal expressly. It was rather obviously designed to extend the exclusion of the statute to pensions and annuities as well as benefits during temporary illness or disability, payable under a wide variety of possible governmental arrangements which might not qualify as "health insurance" under the existing statute.

The Government also contends that the amendment made by the Revenue Act of 1951 to Sec. 22(b) (1) of the

* This ruling is described in the testimony of the president of a subsidiary of A. T. & T. in Hearings before the Committee on Ways and Means, House of Representatives, 83d Cong., 1st Sess., on Forty Topics Pertaining to the General Revision of the Internal Revenue Code, p. 365. He stated: "In 1918 the Bureau issued a ruling that the benefits were not subject to tax. In other words, the payments under our plans were given the same treatment as payments made under commercial insurance policies." The testimony continues with a succinct history of the Internal Revenue Service's vacillation on this issue, and the considerations of equity in favor of an equal application of the law whether a plan is privately or commercially insured.

Revenue Code of 1939 indicates that the term "insurance", as used in the statute here involved does not include self-insured benefit plans (Br. 20). Such amendment added to the then existing provisions of Sec. 22(b)(1), exempting from income taxation "payments under a life insurance contract, paid by reason of the death of the insured", a further provision exempting payments under a contract of an employer within specified limitations.

Sec. 22(b)(1) originated as Sec. II(B) in the Tariff Act of 1913, 38 Stat. 114 (1913). A similar provision was contained in the Revenue Act of 1918, as Sec. 213(b)(1), 40 Stat. 1057 (1919). In both instances the statutory language referred to the "proceeds of life insurance policies". The statute here involved originated in the Revenue Act of 1918, and in it was used the obviously broader term "health insurance". In the Revenue Act of 1926, 44 Stat. 9 (1926), the term "life insurance policies" as used in the statute relating to death benefits (Sec. 213(b)(1) of that Act) was changed to "life insurance contract", the report of the Senate Committee stating that the change was made to conform the phraseology to that used in Sec. 213(b)(2) of the same Act, relating to an exclusion for the return premiums paid on a "life insurance, endowment, or annuity contract", there being no intended distinction between life insurance policies as used in the one and life insurance contract as used in the other (Senate Report No. 52, 69th Cong., 1st Sess., 1939-1 Cum. Bull. (Part 2) 347). No change was made in the term "health insurance" as contained in the subparagraph which was the predecessor statute to the one here involved. Thus, if any inference is to be drawn from the comparison of the histories of Sections 22(b)(1) and 22(b)(5) of the Revenue Code of 1939, the inference would be that Congress deliberately used a

broader term when it used the term "health insurance" and did not intend to confine its scope to conventional or commercial insurance contracts or policies. On the other hand, the history and language of Section 22(b)(1), described above, was such that an amendment was considered necessary in order to cover employee death benefits. The absence of any amendment to Section 22(b)(5) at this time really supports the broader interpretation of that section.

Finally, an effort is made to draw from the comprehensive provisions of the Internal Revenue Code of 1954 an indication of a Congressional construction of the prior law as not exempting payments under a self-insured employer sickness benefit plan. It is extremely doubtful that any inference as to the meaning of the statute here involved, originally enacted more than thirty-five years earlier, can properly be drawn from this recent enactment. Assuming that any such inference is to be drawn, however, it again appears to be contrary to the Government's contention.

The present statutory provisions make no distinction between benefits paid under an employee plan through commercial insurance and under such a plan which is self-insured, thus clearly recognizing that no different treatment taxwise is justified. The scope of the exemption is broadened, in that payments under all accident and health plans for employees are treated as amounts received under accident or health insurance irrespective of whether the plan involved meets the contractual or other requirements of the term "health insurance". Its scope is narrowed in that payments on account of personal injury or sickness which are in lieu of wages, whether made under a self-insured or commercially insured employee plan, are exempt only within specified limitations. Congress in enacting this legislation clearly recognized that all types of employee plans would not qualify as "health insurance" under the

previous statute, which was unquestionably true. It further recognized that confusion existed as to the precise scope of that term, which was also unquestionably true. The Treasury Department itself, in the long period during which the statute had existed, had never issued a regulation in this connection, and had taken varying and sometimes inconsistent positions in its rulings. It is entirely clear that the real effort of Congress was to provide *for the future* a uniform rule of taxation which could be applied equally to all situations; and it was hardly necessary or pertinent for Congress to attempt a resolution, *for the past*, of the questions under prior law. Congress saw fit to differentiate in the treatment taxwise of payments for permanent bodily impairment and payments made during sickness or disability in lieu of wages, but in doing so it provided for no different treatment between payments made directly by an employer under a self-insured plan and payments made through commercial insurance. Except insofar as the new provisions confirm the obvious fact that no reason exists for a differentiation in tax treatment between a self-insured and a commercially insured employee benefit plan, they would appear to throw no light on the construction of the former statute.

We believe that the foregoing puts the significance of the 1954 revision in its proper light, and that the several arguments appearing on pages 22 to 28 of the Government's brief will, when considered in such light, clearly appear without substance: (1) We, as well as the Government (and as did Congress), recognize a lack of uniformity under prior law. (2) The $100 a week limitation has no special significance in respect of prior law, since Congress obviously reached the conclusion that all disability arrangements in lieu of wages should be so limited, whereas under prior law there was no such limit whether or not the plan

was commercially insured. (3) The treatment under the 1954 Code of insurance proceeds where an employee purchases his own policy for cash has no relevance, either, to the meaning of prior law as applied to a self-insured disability benefits plan since the consideration for the coverage is *services*, not cash. As developed later herein, the petitioners do not seek to equate the services with a cash payment.

It is significant that the Government in its brief refers to the administrative interpretation of the pertinent statute only very briefly (Br. 36, n. 22). The reason is obvious. In no administrative ruling has the position been taken that the term "health insurance" includes only commercial insurance policies. The ruling in I. T. 4015, 1950-1 Cum. Bull. 23, which is quoted at page 23 of the brief of *amicus curiae*, expressly recognizes that a plan of the type here involved constitutes "health insurance".* More recent rulings dealing with the question whether self-insured plans are "health insurance" lay down criteria which are clearly foreign to the question of whether the arrangement is in fact insurance, and are based on policy considerations. See, in this connection, Comment, 64 Yale L. J. 222, 227. These rulings continue to recognize, however, that the exemption relates to self-insured as well as commercially insured plans.

It is also highly significant that the Government in its brief suggests no possible reason why Congress might have intended to afford the exemption to payments on account of sickness under a commercially insured employee plan but not under a similar self-insured plan. If the specific benefits here involved had been paid, under this specific plan, through a group insurance policy rather

* That the Commissioner could and did so characterize the plan in I. T. 4015 contradicts the Government's present contention that the common understanding of the term "insurance" would not encompass such a plan.

than directly by the employer, the Government would concede that they would be exempt from taxation. It is difficult to assume that Congress intended to differentiate between the two situations solely in order to encourage the purchase of commercial insurance policies, or to discriminate taxwise between employees receiving identical sickness benefits.

IV.

The Government Has Not Faced the Question Directly, but Has Pointed to a Series of Irrelevant or Inconsequential Considerations to Support Its Position That Insurance Is Not Present.

We have seen that the Court must pass upon the character of the particular Plan in issue, not upon disability benefits, sick leave, and wage continuations generally. We have also seen that although a disability benefit plan is a "fringe benefit" in the employment arrangement, benefits paid are not compensation as such—and certainly not compensation of a kind that Congress would have wanted to exclude from the relief granted in Section 22(b)(5). It is also clear that the exemption is not confined to policies issued by commercial insurance companies; and that the so-called legislative history relied upon by the Government is entirely too "thin" to support either the contrary view or the specific proposition that a plan of the kind here involved does not meet the purpose of Congress in exempting amounts received through "health insurance".

Both the Government and the Court, therefore, must ultimately face the question directly. It is perfectly obvious that Congress——

(1) Avoided restrictive terminology, such as "policies", "proceeds", "insurance contracts", "insurance companies", "conventional insurance", "commercial insurance", and "insurance carrier", and chose to use a simple, broad and generic term—"insurance"—well known in the law and embracing substantially all contractual arrangements for the assumption by one party of a risk of loss by another; and

(2) At the same time sought to relieve from tax amounts received by the taxpayer only because of the misfortune of illness or accident.

The present Plan meets both of these conditions fully, and this fact cannot be obscured by either elaborate speculation as to the precise nuances of various Congressional actions over a period of 36 years, or by listing a series of alleged and inconsequential differences from commercial insurance. Yet the Government's brief does little more. Note the emphasis placed on the following points, *none of which goes to the heart of the matter:*

1. It is stated that the Plan does not fall within the ambit of state regulation of insurance companies (Br. 30). This is totally irrelevant, for the company here is not insuring the general public but only its own employees.

2. It is argued that the benefits provided are governed by the length of service, so that persons with identical risks are not identically insured (Br. 31-32). This overlooks the obvious fact that persons rendering longer service supply a greater consideration. Furthermore, the benefits are certainly keyed primarily to periods of *sickness*, not service. There is no fixed period of "sick leave", and no right to accumulate time for sickness absence; and the gradations in coverage are in broad classes unrelated to the salary

of the employee or the importance of his services or position.

3. It is argued that payments during the first seven days of sickness are taxable, and indistinguishable (Br. 32-33). We do not know whether such payments are taxable or tax-exempt. This has never been decided, and the Court does not have such question before it. We do know that such payments are separately identified and accounted for by the Company in its accounting and other records (R. 27); that they are not made under a disability benefits plan such as is here involved; that there is no written contract establishing a schedule of indemnity on which they are based; and that they appear to be nothing more than permission to certain employees to be absent for a limited time without loss of pay.

4. It is argued that the petitioners are relying upon a "theoretical wage differential" to find a payment of "premiums"; that this is an "esoteric concept derived from subtle and theoretic analysis"; and that Congress has not recognized, in computing income and medical expense deductions, the presence of any such constructive cash premium (Br. 33-35).

This is all far fetched and illustrates how hard-pressed the Government is for argument. The petitioners rely simply on the rendering of *valuable services* as the consideration for the insurance protection —not upon a payment of cash—and there is nothing "esoteric", "subtle" or even "theoretic" about this. Billions of dollars are exchanged for services every year; and their economic worth is as clear, plain and practical as that of property.

5. The alleged necessity of a separate "fund" is also stressed (Br. 36-37). This is one of the least substantial considerations, for insurance originated as an unfunded arrangement (see *Amicus* Br. 27) and the fact is that a separate fund is *not* characteristic of

typical commercial insurance. That is, if the company had procured a group policy covering its Plan, the premium payment would have gone into the general assets of the insurance company and would not have been held as a separate fund for satisfaction of claims under the policy. The general assets of the company here were fully as available, and as much a "separate fund", for such purpose as would have been the general assets of the insurance company.*

6. It is asserted that, unlike commercial insurance, there is no actuarial determination of risks and costs (Br. 37). The trial court so stated (R. 51), but the record is merely to the effect that no contributions to a fund were made (R. 18). The record is actually silent on whether or how costs were determined; but common sense tells us that a cost item of $1,700,000 a year must be considered by the company as substantial, and that actuarial techniques would be used to forecast this expense. In any event, this is at best remote from the issue.

7. It is argued that costs, expenses and benefits of the Plan were treated as any other business expenses. This is, indeed, a vague argument virtually unrelated to the central issue. The record clearly shows that such items were the subject of separate accounting treatment throughout and were always identified as such (R. 25, 27, 29, 30-31).

8. It is certainly not important that the company withheld income tax on the benefits at issue in this particular case (Br. 37) as this was a natural protective step on its own part.

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* It may be noted, in passing, that on p. 36 of its Brief, the Government seems to admit that "commercial" insurance is not essential to the exemption, and in Note 22 cites Service rulings applying the exemption to plans not commercially insured. This suggests that the emphasis on minor features of commercial insurance is misplaced, as we argue above.

9. It is equally unimportant that a single check might include benefits and wages (Br. 37), since the record clearly shows that the amounts included in the check were separately stated in writing to the employee (R. 25, 30-31).

10. Absence of coverage during lay-off periods (Br. 37) is characteristic of commercially insured disability benefit plans.

11. Ineligibility while receiving wages (Br. 37) emphasizes the nature of the benefits as compensation for sickness rather than for services.

12. Payment of discretionary benefits greater than those required under the Plan (Br. 38) makes it all the more clear that those required are contractual in nature.

13. The fact that the Plan is subject to modification prospectively (Br. 38) surely cannot be significant, for insurance policies are commonly subject to cancellation as to losses not yet incurred.

Thus the Government collects a dozen or so supposed indicia of insurance, most of them irrelevant and certainly none of major significance, to argue that "in its totality" the Plan cannot be classified as providing compensation for sickness under health insurance (Br. 30). Yet it fails to inquire directly into the substance of the matter, or to search legal precedent for the meaning of the common legal term used by Congress in the statute. This evasion of the issue is explicable only in terms of inability to face it successfully.

Conclusion

On the basis of the foregoing it is submitted that the Government has totally failed to meet the petitioners' position that the Plan here involved is "health insurance" within the meaning of the statute.

Respectfully submitted,

JOHN H. HUDSON,
WILLIAM R. HUDSON,
521 Mark Building,
98 Alabama St., S. W.,
Atlanta 3, Georgia,
Attorneys for Petitioners.

Certificate of Service.

This is to certify that I have served a copy of the Reply Brief on behalf of petitioners on the following persons, by depositing in the United States mail a copy of said Reply Brief in a properly addressed envelope with adequate postage thereon, as indicated below:

1. Hon. James W. Dorsey, United States Attorney, Old Post Office Building, Atlanta 3, Georgia, by air mail;

2. The Solicitor General, Department of Justice, Washington 25, D. C., by air mail;

3. Hon. Harlan Pomeroy, Trial Attorney, Department of Justice, Washington 25, D. C., by air mail.

This 7 day of March, 1957.

.....

Of Counsel for Petitioners

APPENDIX.

TREASURY DEPARTMENT

WASHINGTON

Office of
Commissioner of Internal Revenue
Address Reply to
Commissioner of Internal Revenue
and Refer to
IT:PA
HCA

Dec. 24, 1918

American Telephone and Telegraph Company,
195 Broadway,
New York, N. Y.

Sirs:

Reference is made to your letter dated December 11, 1918, with reference to T. D. 2747 in which it was held that the proceeds of an accident insurance policy received by an individual on account of personal injuries sustained by him through accident and amounts received by an individual as a result of a suit or compromise for injuries sustained by him through accident do not represent income subject to tax under the Act of September 8, 1916, as amended.

In reply to your inquiry as to the theory upon which the ruling is based and to the taxable status of amounts received by employees under benefit fund plans, you are advised that the ruling was based on Doyle vs. Mitchell Bros., decided by the Supreme Court under date of May 20, 1918, and other cases wherein reference was made to the case of Stratton's Independence vs. Howbert, 231 U. S., 399, 415, in which it was stated that "income may be defined as the gain derived from capital, from labor, or from both combined."

It is therefore held that amounts received by an employee or his personal representative from a benefit fund, which represents payment on account of death, sickness or injury of an employee is not income within the meaning of the Act.

Respectfully,

P. S. TALBERT
Acting Deputy Commissioner.

Supreme Court, U.S.
FILED
AUG 10 1956
JOHN F. DAVIS, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

The issue presented is whether amounts paid to the taxpayer, Gordon P. Haynes, in continuation of his salary during sick leave, are exempt from income tax as "amounts received through * * * health insurance" under Section 22 (b) (5) of the Internal Revenue Code of 1939. The Court of Appeals held that the sick leave plan of taxpayer's employer did not constitute health insurance and that the amounts received were not exempt from tax. The taxpayers assert that this holding is in conflict with *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th). While there are some factual differences between the two cases, we agree that, as the court below acknowledged (Pet. 13–14), a conflict exists.

We also agree that the issue is an important one affecting many taxpayers notwithstanding changes

made by the Internal Revenue Code of 1954.[1] It is estimated that, at the present time, there are pending over 66,000 claims for refund, involving more than $6,620,000, which raise this issue under the 1939 Code. Cases have already arisen in every judicial circuit except the District of Columbia Circuit and the First Circuit.[2] Accordingly, although we believe that the

[1] Section 105 (d) of the Internal Revenue Code of 1954 excludes from gross income amounts received by an employee from his employer, in lieu of wages, for a period during which the employee is absent from work on account of personal injuries or sickness. The exclusion, however, is not applicable to the extent that such amounts exceed a weekly rate of $100 or to amounts attributable to the first seven days of the absence, unless the employee is hospitalized for at least one day during that period.

[2] In addition to the instant case and the *Epmeier* case, *Moholy* v. *United States* (C. A. 9th), decided June 23, 1956 (1956 C. C. H., par. 9745), adopting the Government's position, is the only other case which has been decided by a Court of Appeals. Cases decided by lower courts are as follows:

For the Government:

Cary v. *United States* (D. Neb.), decided April 5, 1956 (1956 C. C. H., par. 9544);

Branham v. *United States*, 136 F. Supp. 342 (W. D. Ky.) (on appeal C. A. 6th, argued June 13, 1956);

Hanna v. *United States* (N. D. Tex.), decided May 25, 1956 (1956 C. C. H., par. 9736) (on appeal C. A. 5th);

Gamble v. *United States* (S. D. Tex.), decided June 4, 1956 (1956 C. C. H., par. 9666);

Oliva v. *Commissioner*, 25 T. C. No. 153 (venue on appeal would lie in C. A. 3d);

McQueen v. *Commissioner*, decided June 19, 1956 (1956 P-H T. C. Memorandum Decisions Service, par. 56,143) (venue on appeal would lie in C. A. 8th);

Townsend, Admr. v. *United States* (S. D. Ill.), decided July 23, 1956;

decision below is correct and the conflicting *Epmeier* decision is erroneous, the Government does not oppose the issuance of a writ of certiorari in this case.

Respectfully submitted.

OSCAR H. DAVIS,
Acting Solicitor General.

AUGUST 1956.

For the taxpayer:

Adams v. *Pitts* (E. D. S. C.), decided April 25, 1956 (1956 C. C. H., par. 9660) (on appeal C. A. 4th);

Herbkersman v. *United States*, 133 F. Supp. 495 (S. D. Ohio) (on appeal C. A. 6th, argued June 13, 1956);

Priebe v. *United States* (D. Ariz.), decided April 9, 1956 (1956 C. C. H., par. 9478) (on appeal C. A. 9th);

Tinsley v. *United States* (W. D. Okla.), decided March 27, 1956 (1956 C. C. H., par. 9604) (on appeal C. A. 10th).

Other cases are also pending in the Court of Claims and District Courts in the Second, Third, Fourth, Fifth, Sixth, Seventh and Eighth Circuits.

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No. 257

In the Supreme Court of the United States

OCTOBER TERM, 1956

GORDON P. HAYNES AND ESSIE M. HAYNES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the Court of Appeals (R. 103–124) is reported at 233 F. 2d 413. The findings of fact and conclusions of law of the District Court (R. 48–52) are reported at 139 F. Supp. 671.

JURISDICTION

The judgment of the Court of Appeals was entered on April 20, 1956. (R. 125.) The petition for a writ of certiorari was filed on July 16, 1956, and was granted on October 8, 1956. (R. 126.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

The taxpayer was absent from work during 1949 because of illness. For the period of such absence, his regular salary, in the amount of $2,100, was paid to him by his employer pursuant to a company plan providing for such payments.

The question presented is whether this $2,100 was taxable as compensation for services rendered under Section 22 (a) of the Internal Revenue Code of 1939, or was exempt from tax as an amount "received, through * * * health insurance" within the meaning of Section 22 (b) (5) of the Code.

STATUTES INVOLVED

The pertinent provisions of Section 22 (a) and (b) (5) of the Internal Revenue Code of 1939 and of Sections 104, 105, and 106 of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 40–44.

STATEMENT

This case involves a claim for refund of federal income taxes collected for the year 1949. The relevant findings of fact made by the District Court (R. 48–51) and the undisputed evidence may be summarized as follows:

During the year 1949, the taxpayer, Gordon P. Haynes, was employed by the Southern Bell Telephone and Telegraph Company. During that year, Haynes became sick and was paid $2,100 in "Sickness Disability Benefits" (R. 72) under a plan of the company called a "Plan for Employees' Pension,

Disability Benefits and Death Benefits" (Pltf. Ex. 1, R. 5, 49, 62–88). The $2,100 paid Haynes under the plan was the same amount which would have been paid him had he worked and received his regular salary. The company withheld $318.44, for income taxes, from the $2,100 paid Haynes, and the former sum was paid by the company to the Collector of Internal Revenue. (R. 49.)

The "Plan for Employees' Pension, Disability Benefits and Death Benefits," inaugurated by the company in 1913, is set forth in terms of company regulations. (R. 49, 62.) It provides for service pensions and for a pension fund (R. 62–69), for "Accident Disability Benefits" (R. 69–71), "Sickness Disability Benefits" (R. 72–73) and "Death Benefits" (R. 73–79). The "Sickness Disability Benefits" are paid to all employees who have more than two years service. The benefits paid to employees differ in amount and duration, varying with the length of service of the employee. For example, employees whose terms of employment have been from two to five years are entitled to full pay for four weeks and one-half pay for nine weeks; employees whose terms of employment have been twenty-five years or more are entitled to full pay for fifty-two weeks. (R. 49, 72). Haynes had been employed by the company over twenty-five years and he was entitled to receive his full salary for fifty-two weeks. (R. 49.)

"Sickness Disability Benefits" are paid under the plan beginning on the eighth calendar day of absence due to illness, unless the employee has received benefits

for a prior period and is again absent on account of sickness within two weeks of the termination of such period. (R. 50, 72–73.) The employees, under some circumstances, continue to receive their full salary during the first week of absence and the company does not distinguish between amounts paid for the first week and amounts paid under the plan. (R. 25, 50.) Benefits are not paid during a period of lay-off and no employee has a right to benefits after his discharge. (R. 49.) Benefits are not paid for any period during which the employee is receiving wages from the company. (R. 73.)

Employees are not required to take a physical examination or make application in order to qualify for benefits under the plan. No contribution of cash is made by the employees in order to qualify. The plan is administered by a general committee of five members who are appointed and serve during the pleasure of the board of directors of the company. The members of the committee are appointed from the operating heads of departments of the company and not over three hours per week is devoted by them to committee work. They are responsible to the board of directors and the president of the company. (R. 50.) The committee's determination of questions arising under the plan is conclusive. (R. 63.) In the event of the absence of an employee for sickness, the secretary of the committee authorizes payment of benefits to the employee, subject to the ratification of the committee. The committee is also empowered to authorize payments in excess of those provided by the

plan and to make loans to employees. In cases of need, the committee has made payments in excess of those provided in the plan. The company has never been sued for "sickness disability benefits." (R. 50.)

The company does not maintain a fund from which "sickness disability benefits" are paid; all such payments are charged to operating expenses. The benefits are not administered by a trust or association and the company has not established a reserve on its books against which to charge such benefits. No insurance reserve has been set up and, unlike payments to the pension fund under the plan, the cost of "sickness disability benefits" is not determined by contributions on an actuarial basis. (R. 50–51.)

Payment to an employee for time actually worked and for "sickness disability benefits" accruing in the same pay period is generally made in one check; where an employee works part of one day and is entitled to "sickness disability benefits" for the remainder of the day, the entire amount paid to him for that day is charged to his regular salary account. Approximately two per cent of the company's pay roll in 1949 represented "sickness disability benefits"; a total of $1,700,000 was paid in such benefits during that year. (R. 51.)

The Southern Bell Telephone and Telegraph Company is not licensed by the State of Georgia to engage in the business of health insurance. Insurance companies which engage in the business of writing health insurance do not usually pay benefits of more than eighty per cent of the insured's salary; in group health

insurance, the limitation is approximately two-thirds of the salary earned. The purpose of such limitations is to provide incentive for the insured to return to work as quickly as possible. It is not the practice of insurance companies to issue policies where the period during which benefits will be paid is dependent upon the length of time the insured has been employed in a particular position. (R. 51.)

The District Court concluded, following *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th), that the $2,100 received by Haynes during the year 1949 was received through health insurance within the meaning of Section 22 (b) (5) of the Internal Revenue Code of 1939, and that it was not includible in gross income. (R. 51–52.) The United States appealed from the judgment of the District Court (R. 54) and the Court of Appeals for the Fifth Circuit reversed. (R. 125.)

SUMMARY OF ARGUMENT

1. The amounts received by taxpayer from his employer in continuation of his regular salary during periods in which he was sick are not exempt from tax under Section 22 (b) (5) of the Internal Revenue Code of 1939 as "amounts received, through * * * health insurance * * * as compensation for personal injuries or sickness," but, instead, represent compensation for services rendered or to be rendered and are taxable as such under the broad reach of Code Section 22 (a). In common understanding, such wage continuations by employers are not regarded as insurance payments or as compensation for sickness. There is nothing in the legislative history or background of Section 22 (b) (5)

which suggests that, in creating this narrow exemption, Congress intended that payments by an employer to an employee during a period of sick leave were to be classified as exempt proceeds of "insurance" rather than as compensation for personal services.

The background of the statutory exemption establishes, on the contrary, that Congress was dealing with amounts received through conventional modes of insurance—proceeds from insurance policies. Moreover, congressional amendments to the 1939 Code providing for exclusion of amounts received as pensions for sickness or injury resulting from service in the armed forces and for the exclusion of military pay during periods of hospitalization would have been unnecessary if employer payments to employees during periods of illness were already exempt as payments through "health insurance." Nor is there any indication that Congress ever envisaged that the Federal Government would be regarded as an insurer in granting sick leave pay to its own employees or that federal employees would be entitled to claim an exemption for that part of their salary attributable to periods of absence on sick leave.

A further indication that Congress recognized that payments by an employer which are prompted by the employment relationship are compensation for personal services and are not "insurance" proceeds is found in Section 22 (b) (1) of the 1939 Code. That section, which exempts amounts received under life insurance contracts, was amended by Congress in 1951 to provide an additional, but limited, exemption

for amounts received under a "contract of an employer" providing for the payment of a fixed amount on the death of an employee. This amendment was deemed necessary by Congress since such payments were not viewed as amounts received through insurance and were otherwise taxable in full. An employer's continuation of wages during illness is no more like insurance proceeds than is a death benefit paid by an employer. Neither is exempt from tax except as Congress makes explicit provisions. Admittedly, no special exemption for wage continuations during illness existed during the taxable year here in issue. Such an exemption (again, limited) was first created in the Internal Revenue Code of 1954.

2. In the Internal Revenue Code of 1954, Congress enacted a comprehensive tax plan dealing with benefits received by an employee from his employer during periods of absence from work because of sickness. Recognizing that such benefits, when received from an employer, are in fact compensation for services and taxable as such, Congress carefully exempted only a limited amount ($100 per week) of such benefits from tax, whether they were directly paid by the employer or were attributable to employer contributions toward conventional health insurance policies for employees. In urging that sick leave benefits were entirely exempt under the 1939 Code, the taxpayer is seeking a broader exemption than Congress thought desirable when it enacted the 1954 Code. Yet, there is no evidence that, in adopting the 1954 Code, Congress was acting to restrict

the tax benefits already available under the 1939 Code to one in taxpayer's position. On the contrary, the entire tenor of the legislative history is that Congress proposed to enlarge the tax benefits available to employees when it legislated so as to exempt a part, but not all, of sick leave pay; and since Congress plainly recognized the compensatory nature of such payments, the 1954 Code furnishes convincing evidence that sick leave payments by employers were not exempt under the 1939 Code as "amounts received, through * * * health insurance."

3. The plan of taxpayer's employer for the payment of sick leave benefits does not have any of the essential characteristics of health insurance. There are no definable premium payments by the employee; there is no separate fund established out of which benefits are paid; there is no actuarial computation of risks involved or assumption of those risks. Yet, all of these are common characteristics and indicia of "insurance." Instead, employees with identical risks are treated differently under the plan, the benefits payable being related, not to risk alone, but to length of employment with the company. As a consequence, the plan tends to encourage and reward long periods of service and is clearly compensation for services. Benefits are not paid during a period of lay-off or for a period in which the employee receives wages from the company. Although employees, in some circumstances, continue to receive their regular salary during the first seven days of illness (a benefit not provided by the plan), these

payments, which are immediately recognizable as taxable sick leave payments, are indistinguishable from those made under the plan, and are not treated any differently by the company from payments under the plan.

Everything points to the conclusion that the amounts involved in this case were paid by taxpayer's employer and received by taxpayer as part of his compensation for personal services rendered or to be rendered. To treat such an important element of compensation as an amount received through "health insurance" requires that this statutory exemption from tax be given a strained construction—one which has no basis in the legislative history and which departs from the ordinary meaning of the words.

ARGUMENT

SICK LEAVE PAYMENTS RECEIVED BY AN EMPLOYEE FROM HIS EMPLOYER REPRESENT A "FRINGE BENEFIT" TAXABLE AS COMPENSATION FOR SERVICES. SUCH PAYMENTS ARE NOT EXEMPT AS AMOUNTS RECEIVED THROUGH HEALTH INSURANCE UNDER SECTION 22 (B) (5) OF THE INTERNAL REVENUE CODE OF 1939

A. PRELIMINARY

At various times during the year 1949, taxpayer, Gordon P. Haynes, was absent from work because of illness. During these periods of absence, he continued to receive amounts equivalent to his normal salary pursuant to a plan of his employer, the Southern Bell Telephone and Telegraph Company. The total

amount which he received during the periods in which he was absent from work in 1949 was $2,100. (R. 49.) Unless Congress has specifically provided for its exclusion from gross income, this amount is clearly taxable as income under Section 22 (a) of the Internal Revenue Code of 1939. Cf. *Commissioner* v. *Lo Bue*, 351 U. S. 243, 247. The question is whether the $2,100 is, in its entirety, excludable from the employee's taxable income as an amount received "through accident or health insurance * * * as compensation for personal injuries or sickness" under Section 22 (b) (5) of the 1939 Code (Appendix, *infra*, pp. 5–6).[1]

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[1] Whether sickness benefits plans of employers for their employees qualify as health insurance within the intent of Congress in Section 22 (b) (5) of the Code is a question which has been before two other Courts of Appeals. In *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th), a plan of the Lincoln National Life Insurance Company was involved. And in *Moholy* v. *United States* 235 F. 2d 562 (C. A. 9th), the plan of the San Francisco Fire Commission was at issue. The *Epmeier* case held, we believe incorrectly, that the plan did constitute health insurance. The Ninth Circuit, in the *Moholy* case, reached the opposite result. The Tax Court also has had occasion to consider this problem in a case involving the sickness benefits plan of the Esso Standard Oil Company. It held that the plan was a sick leave plan which did not qualify as health insurance and that payments made pursuant to the plan were taxable as compensation. *Oliva* v. *Commissioner*, 25 T. C. 1289. See also *McQueen* v. *Commissioner*, decided June 19, 1956 (1956 P–H T. C. Memorandum Decisions, par. 56,143).

In addition, numerous District Courts have considered the problem, reaching divergent results.

Decided for the Government on this issue are: *Adams* v. *United States* (N. D. Tex.), decided April 27, 1956 (not reported); *Branham* v. *United States*, 136 F. Supp. 342 (W. D. Ky.); *Cary*

The case thus presents the narrow problem of ascertaining what Congress meant by the words "health insurance." Did Congress regard payments made by an employer to an employee during periods of absence because of illness as being "insurance" payments which should be *exempt* from income taxation? Or did Congress, in creating an exemption for "health insurance" (as it has for other types of insurance payments received), limit this exception to payments received under normal, conventional modes of insurance, as distinguished from sick leave payments by an employer to an employee (which are usually and quite aptly described as "compensation" for personal services, which is taxable under Section 22 (a) of the 1939 Code, Appendix, *infra*, p. 40)?

We shall argue that the specific indicia of congressional meaning point to the conclusion that Congress did not propose that wage continuations during illness should be classified as "health insurance", but, rather, that such payments, like all other direct economic benefits which flow to an employee as a con-

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v. *United States*, 141 F. Supp. 750 (Nebr.); *Gumble* v. *United States* (S. D. Tex.), decided June 4, 1956 (1956 C. C. H., par. 9666); *Hanna* v. *United States* (N. D. Tex.), decided May 25, 1956 (1956 C. C. H., par. 9736); *Townsend* v. *United States*, 143 F. Supp. 150 (S. D. Ill.).

Cases decided for the taxpayer on this issue are: *Adams* v. *Pitts*, 140 F. Supp. 618 (E. D. S. C.); *Herbkersman* v. *United States*, 133 F. Supp. 495 (S. D. Ohio); *Pfleiderer* v. *United States* (S. D. Ind.), decided July 20, 1956 (1956 C. C. H., par. 9869); *Priebe* v. *United States* (Ariz.), decided April 9, 1956 (1956 C. C. H., par. 9478); *Stanley* v. *United States* (S. D. Ind.), decided July 20, 1956 (1956 C. C. H., par. 9870); *Tinsley* v. *United States* (W. D. Okla.), decided March 27, 1956 (1956 C. C. H., par. 9604).

sequence of the employment relationship, including certain i. e., so-called "fringe benefits", should be taxed as compensation when received." Indeed, as will be seen (pp. 22–28, *infra*), when Congress later intended to give a special, but limited, tax treatment to such wage continuation plans, it dealt with them specifically.

We shall also point out that a sick leave plan is in essence a continuation of wages or compensation. Under such a plan, the employee's compensation is continued, in whole or in substantial part, while he is absent from work, through no fault of his own, because of illness. The employee, as it were, is excused since the employer does not insist that he continue to work while ill as a condition to receiving pay. But what the employee receives is just as much in the nature of compensation as his regular pay. The most familiar example of such an arrangement is the Federal Government's long-standing sick leave plan, under which salary payments to employees continue while they are on such leave.

Before turning to the history of the exemption provision in question, we would emphasize that the decisions uniformly recognize that the definition of taxable income in Section 22 (a), viewed in the light of the evident policy of Congress, is to be given broad application (*Commissioner* v. *LoBue* 351 U. S. 243, 247; *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 429–430; *Commissioner* v. *Jacobson*, 336 U. S. 28, 49; *Robertson* v. *United States*, 343 U. S. 711); conversely, when the claim is that income has been

exempted from tax, the exemption must be "construed with restraint in the light of the same policy" (*Commissioner* v. *Jacobson, supra*, p. 49). With particular reference to compensation for personal services, the decisions have recognized that "income" comprehends any direct economic benefit, whatever its form, which moves from an employer to an employee as a consequence of the employment relationship, whether it be designed to compensate for past, present or future services or even to enlist more efficient services. *Commissioner* v. *LoBue, supra; Robertson* v. *United States, supra; Commissioner* v. *Smith*, 324 U. S. 177, 181, rehearing denied, 324 U. S. 695; *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 729.

B. THE RELEVANT GUIDES TO THE CONGRESSIONAL PURPOSE SHOW THAT AMOUNTS PAID UNDER SICK LEAVE PLANS ESTABLISHED BY AN EMPLOYER FOR HIS EMPLOYEES ARE NOT TO BE CONSIDERED "AMOUNTS RECEIVED, THROUGH * * * HEALTH INSURANCE" WITHIN THE MEANING OF SECTION 22 (B) (5) OF THE INTERNAL REVENUE CODE OF 1939

Section 22 (b) (5) first became a part of the tax law as Section 213 (b) (6) of the Revenue Act of 1918, c. 18, 40 Stat. 1057. Although the legislative history of that section is not extensive, it does reveal that Congress was attempting to provide a solution to a specific type of question. And when that problem, together with its congressional solution, is considered in connection with the sick leave plan here involved, it becomes evident, we submit, that it was not within the congressional purpose to create an exemption from tax for what is essentially remuneration being paid by an employer to an employee.

The report of the House Ways and Means Committee, in discussing what was to become Section 213 (b) (6) of the Revenue Act of 1918, is as follows (H. Rep. No. 767, 65th Cong., 2d sess., pp. 9–10 (1939-1 Cum. Bull. (Part 2) 86, 92)):

> Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.

The doubts which created the problem that Congress attempted to resolve arose in deciding what items were to be treated as "income" under the Revenue Acts. On the administrative level, the taxability of proceeds of accident insurance policies had been the subject of differences of opinion. A Treasury Decision had been promulgated holding that such insurance proceeds were taxable income. T. D. 2135, 17 Treasury Decisions 39 (1915). Thereafter, however, the Secretary of the Treasury requested the opinion of the Attorney General as to whether "the proceeds of an accident insurance policy received by an individual on account of personal injuries sustained by him through accident are income taxable" under the Revenue Acts of 1916 and 1917. The Attorney General concluded (31 Op. A. G. 304 (1918)) that such proceeds were not taxable income. This opinion was based upon an interpretation of the

then recent decisions[2] of this Court holding that returns of capital were not income. The Attorney General was of the view that the proceeds of an accident insurance policy were a substitute for "capital which is the source of future periodical income," merely taking "the place of capital in human ability which was destroyed by the accident". (31 Op. A. G. 304, 308 (1918).) In accordance with this theory, the Treasury then ruled[3] that proceeds of accident insurance policies were not taxable income and revoked parts of its earlier decision to the contrary.

It is against this background—one of recurrent doubt on the part of officials of the executive establishment as to the taxability of accident policy proceeds—that the Congress decided to exempt "amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injuries or sickness." The plain inference is that Congress proposed to exempt only "proceeds" received under conventional modes of insurance.[4]

Nothing in the background or history of the exemption provision remotely suggests that a continuation of wages or salary during a period of

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[2] *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179; *Lynch* v. *Turrish*, 247 U. S. 221; and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330.

[3] T. D. 2747, issued July 12, 1918, 20 Treasury Decisions 457 (1918).

[4] The Seventh Circuit, in the *Epmeier* case, was of the opinion that Section 22 (b) (5) was enacted with the intention of giving relief to taxpayers who have the misfortune to become ill. See 199 F. 2d 508, 511. The legislative history and background of the section offer no support for this theory.

illness was to be treated for tax purposes differently from other types of compensation. The opinion of the Attorney General and the Treasury Decisions did not deal with payments to employees by an employer. They considered only the usual kind of "*proceeds*" from an "accident insurance *policy*". [Emphasis added.] (31 Op. A. G. 304 (1918).)[5] See also T. D. 2747, *supra*.

As a matter of everyday speech and usage, the plan involved in the instant case is not thought of as "health insurance"; it would be called a "sick leave" plan. There is no reason to suppose that, in using the expression "health insurance", Congress meant anything other than conventional insurance.[6] The presumption that Congress was using "health insurance" in its usual sense is, of course, buttressed by the references in the background of the statute to *proceeds* from an *insurance policy* and by the fact that Congress intended to exempt from tax only those kinds of receipts that, in the then current stage of development of tax law, were thought to be analogous to returns of capital. Indeed, if the purpose of Congress had been to exempt from tax any amount received by an employee during

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[5] In the event that an employer paid all or a part of the premiums on an individual accident or health insurance policy for an employee, the payments by the employer would, in the absence of a specific exclusion, be includible in the employee's gross income. Cf. Rev. Rul. 210, 1953-2 Cum. Bull. 114.

[6] The normal rule that, absent special indications to the contrary, words in a statute are to be given their everyday meaning (*Crane* v. *Commissioner*, 331 U. S. 1, 6) applies with particular force here since the taxpayers are urging that this Court adopt an expansive interpretation of an exemption section.

a period of illness, the statute would doubtless have been drafted differently.[7] Apart from the fact that an employer's continuation of wages during illness is compensation for past and future services and is not "compensation for personal injuries or sickness", the qualifying phrase "through accident or health insurance or under workmen's compensation acts" must be given effect. We submit that any meaning which can be fairly assigned to this phrase is not broad enough to encompass a plan of an employer whereby his employee, in consideration for both his past and future services, can expect to receive his regular compensation, in whole or in part, during a certain period of illness.

Further support for the position that Congress did not view the "health insurance" exemption as broadly as taxpayer is evidenced by an amendment made in 1942. From 1918 until 1942, Code Section 22 (b) (5) and its predecessors had remained unchanged. By Section 113 of the Revenue Act of 1942, c. 619, 56 Stat. 798, language was added so as to include in the exemption "*amounts received* as a pension, annuity, or similar allowance *for* personal injuries or *sickness* resulting

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[7] Section 1426 (a) (2) of the Internal Revenue Code of 1939, as amended by Section 203 (a) of the Social Security Act Amendments of 1950, c. 809, 64 Stat. 477, demonstrates that when Congress intends to describe this kind of payment it knows how to do so specifically. This section also indicates that Congress considered these amounts "wages" and thought that a specific exception was necessary to prevent them from being included in the definition of that word. Cf. Section 1607 (b), Internal Revenue Code of 1939, as amended by Section 209 (a) of the Social Security Act Amendments of 1950.

from active service in the armed forces of any country."[8] (Emphasis added.) If taxpayer's approach to the statute and the expansive concept of "insurance" which he urges are correct, there would have been no need for this amendment and the limited exemption which it added. That is, if the taxpayer is right in contending that a plan whereby an employer undertakes to pay all or a part of an employee's remuneration during periods of disability for illness is "health insurance" within the contemplation of the statute, it would similarly be true that the payments described by the 1942 amendment are received through health insurance. But Congress, quite obviously, in making the amendment did not regard the statute as being so broad.[9]

In this connection, it should be added that the Federal Government had (as it still does) a sick leave plan for its employees, providing for a continuation of salary in the event of illness. See Act of March 3, 1893, c. 211, 27 Stat. 675, 715, Sec. 5, as amended by the Act of March 15, 1898, c. 68, 30 Stat. 277, 316, Sec. 7; Act of July 7, 1898, c. 571, 30 Stat. 652, 653, Sec. 1; and Act of February 24, 1899, c. 187, 30 Stat. 846, 890, Sec. 4. Undoubtedly, Congress was aware of the existence of these benefits being paid to Government employees when the predecessor of

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[8] Section 127 (d) of the 1942 Act also amended Code Section 22 (b) (5) in another respect which is discussed *infra*, pp. 34–35.

[9] See also 1939 Code Section 22 (b) (13) (A) (ii) and (B) (ii), as amended by Section 305 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452, dealing with a special exclusion for military pay during a period of hospitalization.

Section 22 (b) (5) found its way into the law. Yet, there is no basis for believing that Congress viewed the Federal Government as giving "health insurance" to its employees and as acting in the capacity of an insurer. The taxpayer's arguments [10] would lead to the conclusion that Congress intended to exempt a federal employee's salary for every hour, day or week of absence on sick leave—a conclusion most difficult to accept, particularly in view of the limited exemption for military personnel created by the 1942 amendment.

There is still another indication that Congress drew a distinction between conventional modes of insurance and payments made by an employer. In Section 22 (b) (1) of the 1939 Code (26 U. S. C. 1952 ed., Sec. 22), as in predecessor statutes, Congress provided that "Amounts received under a life insurance contract paid by reason of the death of the insured" should not be included in gross income. By Section 302 of the Revenue Act of 1951, c. 521, 65 Stat. 452, Congress amended this section to read as follows:

> (1) *Life insurance, etc.*—Amounts received—

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[10] The *amicus curiae* brief (p. 24) attempts to distinguish *Moholy* v. *United States*, *supra*, on the ground that it involved the sick leave plan of the San Francisco Fire Commission. There is no basis for such a distinction. The rights of an employee under such a plan are not less because the employee is a civil servant and his rights are provided for by statute or municipal regulations rather than a pamphlet of the type issued by the telephone company in this case. Cf. *Sleigh* v. *United States*, 9 C. Cls. 369.

(A) under a life insurance contract, paid by reason of the death of the insured; or

(B) *under a contract of an employer providing for the payment of such amounts to the beneficiaries of an employee, paid by reason of the death of the employee;*

* * * The Aggregate of the amounts excludible under subparagraph (B) by all the beneficiaries of the employee under all such contracts of any one employer may not exceed $5,000. [Emphasis added.]

This amendment was explained by the Committee on Finance of the Senate in the following manner (S. Rep. No. 781, 82d Cong., 1st sess., p. 50 (1951–2 Cum. Bull. 458, 492):

> Section 22 (b) (1) of the code excludes from gross income amounts received under a life-insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise. *However, by its terms, this provision is limited to life-insurance payments, and the exclusion does not extend to death benefits paid by an employer by reason of the death of an employee.* [Emphasis added.]

Section 22 (b) (5) excludes amounts received through accident or health insurance. Section 22 (b) (1) excludes amounts received under a life insurance contract. And when Congress desired that death benefits paid by an employer to a deceased employee's beneficiary should be exempt, it considered that "by its terms" Section 22 (b) (1) was "limited to life insurance payments," and that the exclusion did "not extend to death benefits paid by an employer by

reason of the death of an employee." S. Rep. No. 781, *supra*. Certainly, if a plan such as the one in the instant case, which also provides for death benefits (R. 73–79), was thought by Congress not to be a "life insurance contract" within the meaning of Section 22 (b) (1), and Congress, therefore, deemed it necessary to amend the statute to provide for a limited exclusion of benefits paid under such a plan, Congress similarly must have considered that such a plan, in providing for sick leave benefits, was not a "health insurance" contract within the purview of Section 22 (b) (5). And the absence of any amendment to provide for the exclusion of such sick leave benefits, at a time when Congress recognized that companion death benefits were not excluded by Section 22 (b) (1) and changed the law in that respect,[11] furnishes convincing evidence that Congress did not intend that sick leave benefits should be exempt from tax.

C. THE COMPREHENSIVE CHANGES ADOPTED BY CONGRESS IN THE INTERNAL REVENUE CODE OF 1954 SUPPORT THE CONCLUSION THAT AN EMPLOYER'S SICK LEAVE PLAN WAS NOT HEALTH INSURANCE UNDER SECTION 22 (B) (5) OF THE 1939 CODE

In enacting the Internal Revenue Code of 1954, Congress adopted (Sections 104 through 106, Appendix, *infra*, pp. 41–44) a comprehensive tax policy for

[11] The limitation placed on the exclusion of death benefits paid by an employer is a further indication that Congress has recognized the nature of such a "fringe benefit" to be compensation and normally taxable as such, and that it has proceeded slowly in this area by exempting from tax only a portion of the otherwise taxable compensation.

dealing not only with health and other similar insurance payments, but also with various types of payments made by an employer to an employee. Since these changes reflect congressional understanding of the provisions of the 1939 Code, they provide an aid to interpretation.

1. Congress recognized that Section 22 (b) (5) of the 1939 Code was limited to amounts paid "under a contract of insurance" and that employees who received sick benefits were subject to "substantially different tax treatment" depending on the technical nature of the plan under which the benefits were made available. H. Rep. No. 1337, 83d Cong., 2d sess., p. 15 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4039). Referring, with seeming disapproval, to the decision in *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th) and its holding that "health insurance" was there involved even though there was "no formal insurance policy but merely an employer's plan for payment of sickness benefits" (H. Rep. No. 1337, *supra*, p. A33), the House Committee on Ways and Means proposed to enact a "uniform rule" for payments "received by an employee" without regard to whether "such amounts are funded through insurance" (H. Rep. No. 1337, *supra*, p. A33 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4169)). See also S. Rep. No. 1622, 83d Cong., 2d sess., pp. 15, 183–186 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4645, 4817–4820).

If Congress had viewed Section 22 (b) (5) of the 1939 Code as already embracing all employers' plans for wage continuations during illness, regard-

less of whether accomplished through conventional modes of insurance, there would have been no lack of uniformity under existing law which called for legislative correction.[12]

2. That Congress did not view a mere plan to continue wage payments during illness as already embraced by the *total* exclusion granted under the 1939 Code to "health insurance", is evident, too, from the fact that, in extending the exclusion to employers' wage continuation plans, Congress *limited* the amount which would be non-taxable where an employment relationship exists. That is, where payments are received by an employee "in lieu of wages" during absence from work on account of sickness or injuries, an amount *not in excess of $100 per week* is excludable from taxable income and any amount in excess of that continues to be taxable. Furthermore, there is no exclusion for payments during the first week of illness, unless the employee has been hospitalized for at least one day during that period. 1954 Code Section 105 (a), (d) and (e). In contrast, where the payments are received under a conventional mode of accident or health insurance by a taxpayer and the insurance is not attributable to

[12] It is also of some significance that, in providing for a uniform scheme of taxation, Congress found it necessary to state expressly in Section 105 (e) of the 1954 Code that "for purposes" of Sections 104 and 105, amounts received under a "health plan" for employees "shall be treated" as amounts received through "health insurance"—a plain indication that the normal usage of the term "health insurance" would not, except for express statutory direction, include such plans.

an employment relationship, the *entire* proceeds are exempt from tax, as they were under the 1939 Code. 1954 Code Section 104 (a) (3). Congress has thus recognized that compensation for personal services is necessarily involved where an employment relationship exists and has drawn a distinction between wage continuations received by employees during illness and sick benefits received by others. The former were granted a limited exemption, while the latter (who would normally receive payments only because of an insurance arrangement) continue to have a total exemption.[13]

If it be true, as taxpayer contends, that payments under all employer plans were already exempt in full under the 1939 Code, Congress, by limiting the exempt amount to $100 per week and by allowing no exemption for the first week's payments, sharply restricted the benefits available under existing law. But there is not the slightest suggestion in the legislative history that Congress was taking away tax benefits from those receiving monies under wage continuation plans. On the contrary, the entire tenor of the legislative history is that, where such employer payments are involved,

[13] Where an employment relationship exists *and* policies of insurance are taken out, Congress has provided as follows: To the extent that part of the premium is paid by the employee, a proportionate part of the insurance payments is entirely exempt from tax. To the extent, however, that part of the cost is paid by the employer, the remaining, proportionate part which is received by the employee during illness is not entirely exempt, but is subject to the limitations described above. This is an obvious recognition that what the employee receives as a consequence of the employer's contribution is essentially compensatory in nature.

Congress was enlarging (to a limited degree) the tax benefits of an employee, just as it had previously done in connection with death benefits paid by an employer. See pp. 20–22, *supra*. In sum, Congress was unwilling to do what the taxpayer, in effect, is urging this Court to do, namely, grant a total exclusion for such wage continuations during illness.[14]

3. The 1954 Code provisions also illustrate that the taxpayer's attempt to equate a wage continuation plan with conventional concepts of insurance is erroneous in another respect. Taxpayer contends that an employee, by rendering services, is furnishing consideration (Br. 14–15). This presumably means that the employee receives less in the form of cash wage payments when on the job than he would be entitled to receive if the employer made no provision for wage continuations during illness. And it is urged that this theoretical wage differential is, in substance, a premium paid for the "insurance" afforded by the

[14] The 1954 Code does narrow pre-existing law in the situation where the employer pays premiums on health insurance for his employees. Payments under such contracts of insurance were entirely exempt to the employee under Section 22 (b) (5) of the 1939 Code, while the limitations of 1954 Code Section 105 (d) apply to the proceeds of such insurance and they apply to a proportionate amount of the proceeds where both employer and employee pay part of the cost. See footnote 13, *supra*.

But 1954 Code Section 106 gives a corresponding benefit not available under the 1939 Code, for it excludes from the employee's taxable income any contributions made by the employer for such insurance and thereby gives a tax benefit to the employee to the extent that such contributions might otherwise have been includible in his income when made, *viz.*, as where the employer took out individual policies for individual employees.

employer during periods of illness. See also brief of the *amicus curiae*, pp. 13, 22.

As we show, pp. 29–39, *infra*, the analogy between insurance and wage continuations is a dubious one. We here emphasize that Congress, even in the liberalizing provisions of the 1954 Code, chose to distinguish between cash wage payments received by an employee, part of which he uses to pay for a health insurance premium, and equivalent benefits indirectly conferred by an employer. The total cash wages actually received are taxable as income to the employee in the year of receipt, while the health insurance proceeds which he receives and which are attributable to the premiums paid by him are exempt from tax. On the other hand, no matter how the employer makes provision for sick benefits, the employee has no taxable consequences until a period of illness and then only a limited exemption becomes operative. In other words, Congress has *not* adopted the theoretical approach which the taxpayers urge. (Cf. taxpayers' Br. 20–21.)

The 1954 Code shows, in brief, that Congress regarded a wage continuation plan as a direct payment of compensation for services rendered, or to be rendered, just as is true of paid vacations, year end bonuses, pensions,[15] death benefits, profit sharing plans, stock option

[15] Arguments similar to those advanced in this case have been made by taxpayers attempting to have retirement pensions, paid to them by their employers, taxed as "annuities" under Section 22 (b) (2) of the Internal Revenue Code of 1939. The courts have realistically recognized, however, that such benefits are received by the employees for services rendered and are not an-

plans and other kinds of benefits. For some of these so-called fringe benefits, Congress has made special provision in the tax laws, as it has now done for wage continuation plans during illness.[16] But, as is evident, Congress did not view the narrow exemption previously accorded "health insurance" in the 1939 Code as embracing such wage continuation plans.

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nuities in the statutory sense. See *Hooker* v. *Hoey*, 27 F. Supp. 489 (S. D. N. Y.), affirmed, 107 F. 2d 1016 (C. A. 2d); *Wolfe* v. *Commissioner*, 8 T. C. 689, affirmed, 170 F. 2d 73 (C. A. 9th), certiorari denied, 336 U. S. 914.

In *Menke* v. *Thompson*, 140 F. 2d 786, 791 (C. A. 8th), a pension plan voluntarily established by an employer was not thought to be a contract of insurance, although by applying the reasoning advanced by taxpayers in this case it might be labeled "old-age insurance." See also *Waller* v. *United States*, 180 F. 2d 194 (C. A. D. C.), where the court, refusing to give a labored interpretation to Section 22 (b) (5), held that amounts received under a federal statute as a result of retirement for physical disability were not in the nature of workmen's compensation.

[16] For a discussion of some of the tax problems and the legislative solution see: Bomar, *Requirements for Qualification of Plans (Compensation Problems: Pensions and Profit-Sharing)*, 13 N. Y. U. Institute on Federal Taxation (1955) 395; Block, *Deductibility of Employer Contributions to Qualified Pension and Profit-Sharing Plans*, *id.*, p. 409; Hodgkin, *Taxability of Benefit Payments under Qualified Pension and Profit-Sharing Plans*, *id.*, p. 429; Alexander, *Tax Status of Pension Trusts: Requirements for Maintaining Exemption*, *id.*, p. 435; Young, *Deferred Pay Plans—Qualified and Non-Qualified Plans*, *id.*, p. 457; Beck, *Family Benefits and Family Security: Employee Death Payments*, *id.*, p. 471; Lentz, *Stock Ownership Plans—Options, Warrants, Leverage Stock*, *id.*, p. 499; Gordon, *Health and Welfare Plans—Other Fringe Benefits*, *id.*, p. 521.

D. THE PAYMENTS RECEIVED BY THE TAXPAYER FROM HIS EMPLOYER WHILE ABSENT FROM WORK WERE TAXABLE WAGES; THEY WERE NOT TAX-EXEMPT PROCEEDS OF HEALTH INSURANCE

The taxpayer's argument is essentially this—the wage continuation plan has the essential characteristics of insurance in that the company, by a binding contractual obligation, has, for a consideration (paid by the employee in the form of services), agreed to indemnify (to an extent) its employees against loss of wages due to illness, and thereby the risks which the employees would otherwise bear have been shifted to the employer.

The word "insurance," however, is not a term which has a sharply defined, inflexible meaning which can be applied without regard to the context in which it is used or to the factual situation being tested. As the court said in *Jordan* v. *Group Health Ass'n,* 107 F. 2d 239, 245, fn. 13 (C. A. D. C.):

> Each word, "insurance" and "indemnity", is used in a great variety of situations and with meanings which vary according to that in hand. General definitions torn from the context of specific facts and legal issues do not help greatly, often merely confuse. Some are so all-covering as to embrace nearly the entire law of contract. Cf. (1937) 23 Corn. L. Q. 188, 193.

We have already examined (pp. 14–18, *supra*) the context in which Congress has used the term "health insurance." We now turn to an examination of the so-called plan of the employer which is involved in this case to demonstrate that, viewed in its entirety,

it could not properly be regarded as providing anything except compensation for services, and that it could not properly be classified as "compensation for * * * sickness" under "health insurance" as Congress used these terms in Section 22 (b) (5). Standing alone, no one aspect of the plan need be considered decisive; in its totality, the plan is clearly one for providing a form of compensation to the employees for their services to the company.[17]

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[17] The fact that a contract, such as a contract of employment, provides incidentally for an added benefit to the employee on the happening of a stated contingency does not make it a contract of insurance for regulatory purposes. Vance, *Insurance* (3d ed.), p. 88. On the contrary, such payments when made are merely additional compensation. In *Beck* v. *Penna. R. R. Co.*, 63 N. J. L. 232, a relief fund was maintained jointly by the railroad and its employees providing for the payment of benefits to contributing employees if they became disabled or sick. Holding that the relief fund by its terms released the railroad from any additional liability growing out of the personal injury to Beck, if he chose to accept the benefits of the fund, and that the relief fund was not a contract of insurance and did not violate the New Jersey insurance laws, the court said (pp. 241–242):

> "A contract of similar import with a railway company which had established what was called a railway insurance society was held by the Court of Queen's Bench to be a labor contract between employer and employe. *Clements* v. *L. & N. W. Railway Co.*, 2 Q. B. 482 (1894). The contract before us is *the contract of an employer with an employe respecting the compensation the latter shall receive for his labor*, and the manner in which it shall be accounted for and paid for his relief or the benefit of his beneficiaries. *The payment by the company of the expenses of management and of contributions, to make up deficiencies is in the nature of additional compensation for labor* to those of its employes who enter into this contractural relation with it." [Emphasis added.]

See also *Sherer* v. *Smith*, 85 Ohio App. 317, 320; *Colaizzi* v. *Pennsylvania R. R. Co.*, 208 N. Y. 275, 286–287; cf. *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182.

1. The extent to which an employee will receive payments under the plan is directly related to length of service. (R. 72.) An employee who has been in employment for less than two years is entitled to nothing. Employees with more than two years' service receive payments equivalent to a stated number of weeks' full pay and half pay on an ascending scale, dependent on the number of years of employment. The longer the employment, the longer the period and amount of full pay received during absence attributable to illness.

The plan, without question, has the effect of rewarding and hence encouraging long periods of service. This is a desirable objective in the employer-employee relationship with obvious benefits to both parties. It tends to reduce labor turnover and the resulting stability of employment obviously redounds to the employer's benefit. The advantages to the employee are equally obvious. But what the employer pays and what the employee receives necessarily represents a reward for past services and is designed to encourage future services. This is compensation for services (even though the employee is not at work during the period). See *Commissioner* v. *LoBue,* 351 U. S. 243, 247; *Robertson* v. *United States,* 343 U. S. 711, 715. It can scarcely be distinguished from a paid vacation. It cannot be equated with "compensation * * * for sickness", which is what is exempt under Section 22 (b) (5).

Conversely, the plan does not resemble insurance in that persons subject to identical risks are not neces-

sarily entitled to equal "benefits." Loss of wages due to illness is as much a risk for the employee who has been in employment for less than two years as it is for the employee with two years' service. Yet the former will receive nothing, while the latter will receive payments for a limited period, although he will receive less than an employee with a longer period of service. Yet, assuming that these employees receive identical wage payments while on the job, each has, under the taxpayer's theory, made the same premium contribution to the employer in the form of services rendered.

Another feature of the telephone company's treatment of its employees during periods in which they become ill is worthy of note. During the first seven days of illness, the employee is not entitled to benefits under the plan. (R. 72.) Apparently, however, the employee continues, in some circumstances, to receive his salary during this period. (R. 15, 25, 27–29, 50, 72–73.) There can be no doubt that such an employee is protected during the first seven days as fully as he would be under the plan. The consideration furnished by the employee (his services) is the same; the continuation of salary by the company is the same; and the risk feature is at least equally as great. Yet no contention is made that amounts received during this period of seven days are received through "health insurance", even though, if the employee enters his employment with the understanding that this is part of his compensation, his rights to these amounts would be enforceable as contract rights. The company does

not distinguish between payments for the first seven days and payments made under the plan (R. 25), and, indeed, the only possible distinction is that the plan has been set forth in writing for the employee while no written provision has been made for payments for the first seven days. And this formal difference, we submit, is not sufficient to convert what are immediately recognizable as sick leave payments, which are taxable, into health insurance payments which are non-taxable.

2. Insurance, as the term is normally understood, involves a payment of premiums by those who, sharing a common risk of loss, are enabled to shift it to another, thus providing a fund which can serve to idemnify those who actually suffer a loss. In the present situation the employees paid no premiums. Nor did the employer pay anything resembling premiums on insurance.

Taxpayer contends, as we have already noted, that each employee furnishes consideration by performing services and that this, in reality, is the equivalent of premium payments. (Br. 14–15.) Presumably, the taxpayer assumes that each employee, because of the existence of the plan, received less of a cash wage payment than he would have received if there had been no plan, and that this theoretical wage differential represents the premium payments just as though the employees had received larger wages and had made a direct expenditure for premium payments on insurance.

But there is not the slightest indication that Congress, in using the word "insurance", was legislating

in terms of "some esoteric concept derived from subtle and theoretic analysis." [18] *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 561. Any form of additional compensation, such as pensions, death benefits, etc., could be equated as an abstract matter to a wage differential which might otherwise be paid by the employer in the form of direct compensation. Yet, quite plainly, an employee is not regarded as paying "premiums" for these benefits.

In this connection, it is significant that under Section 22 (b) (5) of the 1939 Code, and even under the 1954 Code with its expanded tax benefits, Congress differentiated between the situation where the employee uses part of his regular wages for the payment of insurance premiums and the case in which he receives compensation from his employer during illness.

Thus, Section 22 (b) (5) of the 1939 Code was amended by Section 127 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798, to exclude from the exemption "amounts received for compensation for personal injuries or sickness which are attributable to and not in excess of deductions allowed under section 23 (x) in any prior taxable year." See S. Rep. No. 1631,

[18] Even from a theoretical viewpoint, the taxpayer's assumption will not withstand analysis. Thus, employees who perform identical services and receive identical wage payments, would be paying the identical, theoretical "premium" under the taxpayer's analysis and each, of course, is subject to the same risk of loss. Yet the employee who has less than two years of service is not "insured", and the employee with two years of service has much less "insurance" than the employee with 25 years of service. This, indeed, would be a strange kind of "premium" payment.

77th Cong., 2d sess., pp. 95–96 (1942–2 Cum. Bull. 504, 576–577). Section 23 (x) contemporaneously added to the Code [19] (26 U. S. C., 1952 ed., Sec. 23), provides for the deduction of extraordinary medical expenses. This section, too, referred to "accident or health insurance" and in this context there is no doubt that Congress was thinking in terms of commercial insurance, for which the insured was paying a cash premium.[20] Thus, the employee who receives a cash wage and uses a part of it to pay premiums on a health insurance policy would be taxed with the full amount of his salary and would be entitled to a deduction only to the extent that the premium payments and other medical expenses qualify for the limited deduction granted by Section 23 (x). But where, as here, the employee receives a cash wage and the employer maintains a wage continuation plan, there is not the faintest indication that Congress intended to tax the employee with a weekly wage rate in excess of that actually received while on the job, or that a theoretical wage differential should be considered as having been paid by him as premiums for "health insurance" which would qualify for deduction under Section 23 (x).

3. A further significant difference between the situation exemplified by this case and one where there is a

[19] Section 127 (a), Revenue Act of 1942, *supra*.

[20] There is no reason to suppose that Congress used the phrase "accident or health insurance" differently in Section 23 (x) than it did in Section 22 (b) (5), especially since Section 23 (x) is referred to specifically in Section 22 (b) (5). Cf. *United States* v. *Olympic Radio & Television*, 349 U. S. 232.

conventional insurance arrangement lies in the fact that no fund was created which could serve as a source for the payment of "insurance."

It need not be decided whether, in using the term insurance, Congress intended to limit the exclusion to payments made by companies which are regulated by the states as "insurance" companies.[21] It is enough to say that where no definable premiums are paid and no separate fund exists to assure the payment of claims, the situation is one which does not resemble insurance, as that term is ordinarily understood.[22]

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[21] The employer here was not licensed to engage in the insurance business. (R. 51.) In the *Epmeier* case, the company involved was an insurance company that engaged in the business of writing health insurance policies. 199 F. 2d 508, 509. It is not possible to state just what weight was given to that fact in *Epmeier*.

[22] The reliance of the *amicus curiae* (Br. 23–24) upon I. T. 4015, 1950–1 Cum. Bull. 23, is misplaced. The position of the Internal Revenue Service to the effect that voluntary employer sick leave plans were not health insurance was set forth in G. C. M. 23511, 1943 Cum. Bull. 86. The ruling in I. T. 4015 was apparently influenced by the fact that the plan met with requirements of the California Unemployment Insurance Act. In I. T. 4107, 1952–2 Cum. Bull. 73, the Service modified I. T. 4015 and stated plainly that compliance with insurance requirements of state law did not necessarily mean that a plan was health insurance within the purview of Section 22 (b) (5). See also Rev. Rul. 209, 1953–2 Cum. Bull. 104.

Where the employees make no direct contributions, or where no separate fund exists for the payment of benefits, or where the amount of benefits are related to length of employment, the Service has ruled that the exemption of Section 22 (b) (5) is not applicable. See Rev. Rul. 54–1, 1954–1 Cum. Bull. 29; Rev. Rul. 209, 1953–2 Cum. Bull. 104; I. T. 4107, 1952–2 Cum. Bull. 73. But where benefits are payable without regard to length of service, a separate fund is established for the payment of benefits, the employees make direct contributions to the fund, and the employer

The absence of any fund is particularly significant for, as we have seen (p. 23, *supra*), the congressional understanding was that Section 22 (b) (5) of the 1939 Code applied only where the "amounts are funded through insurance." H. Rep. No. 1337, *supra*, p. A33 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4169).

Still other relevant circumstances support the view that this case does not involve "insurance" in the accepted sense—the absence of any actuarial computation of the risks which might be incurred and the cost of assumption of those risks (R. 51); the fact that the employer treated expenses of the operation of the plan and the costs of benefits paid under the plan in the same manner as other expenses of doing business (R. 99); the fact that the company withheld income taxes on the payments made to taxpayer under the plan; the fact that payment to an employee for time actually worked and payment under the plan, if occurring in a single pay period, were made in the same check (R. 51);[23] the fact that the employee received no benefits during a period of lay-off even if he were ill in that period (R. 81); the fact that no benefits were paid if the employee was receiving wages from the company (R. 73); the fact that the plan

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administers the fund in accordance with provisions of state law, the benefits received from the fund by contributing employees have been held to qualify for exemption under Section 22 (b) (5). Rev. Rul. 208, 1953-2 Cum. Bull. 102.

[23] Normal pay roll deductions for insurance premiums, purchase of United States bonds and the like are made from amounts paid to employees under similar plans. See *Cary* v. *United States*, 141 F. Supp. 750, 756 (Nebr.), and *Townsend* v. *United States*, 143 F. Supp. 150, 152 (S. D. Ill.).

provided that the company, if it desired to do so, could pay greater amounts than provided for in the plan (R. 50); and the fact that the plan could be changed at the will of the employer (R. 88).[24] Instead, these circumstances point to the conclusion that the plan was intended to furnish additional compensation to employees in consideration of their services.

In the final analysis, this case involves nothing more than an agreement by the telephone company to continue paying its employees their salary if they become sick and are not able to come to work. As the Tax Court stated in *Oliva* v. *Commissioner*, 25 T. C. 1289, 1294:

> What the employer did, as we view the facts, is nothing more nor less than undertake to pay "sick leave pay" to petitioner or, to put it another way, to keep petitioner on the payroll during certain periods of illness when he was unable to work. There is a difference, to our way of thinking, between "health insurance" and the sick benefits payable under the Disability Benefit Plan, which, while hard to define, nevertheless exists. Sick pay is essentially tied into the employer-employee relationship. Such pay is earned by the employee as he works. He pays for it in no other way. No

[24] The *Epmeier* case stated that it was unimportant that the terms of the plan could be changed at will by the company since the employee could always terminate his employment. 199 F. 2d 508, 511. This reasoning, however, leads to the conclusion that this is not health insurance, but rather an element of compensation. It would indeed be strange for an employee to have to terminate his employment because the terms of a "health insurance" policy were not satisfactory to him.

premiums are collected from him and no insurance fund exists. Fundamentally the amounts paid to petitioner fall within the broad definition of "gross income" contained in section 22 (a) which includes "income derived from salaries, wages or compensation for personal service." They are compensatory in nature, paid to him because he was an employee and not because his employer insured him against sickness.

To treat sick leave payments as health insurance payments requires that the language of Section 22 (b) (5) be given an interpretation which does not conform to the general understanding of the words "health insurance". Congress, in liberalizing the law in the 1954 Code, has not gone so far as the taxpayers urge. Congress has recognized that a fringe benefit, such as sick leave, is compensatory in character and it has provided that only limited amounts of sick leave payments may be excluded. There is no basis for suggesting that such payments were exempt *in toto* even before Congress liberalized the law.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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FEBRUARY 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(5) [as amended by Secs. 113 and 127 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Compensation for injuries or sickness*).—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23 (x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus

the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Internal Revenue Code of 1954:

SEC. 104. COMPENSATION FOR INJURIES OR SICKNESS.

(a) *In General.*—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service.

(b) *Cross References.*—

(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.

(2) For exclusion of part of disability retirement pay from the application of subsection (a) (4) of this section, see section 402 (h) of the Career Compensation Act of 1949 (37 U. S. C. 272 (h)).

(26 U. S. C. 1952 ed., Supp. II, Sec. 104.)

SEC. 105. AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.

(a) *Amounts Attributable to Employer Contributions.*—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

(b) *Amounts Expended for Medical Care.*—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213 (e)) of the taxpayer, his spouse, and his dependents (as defined in section 152).

(c) *Payments Unrelated to Absence From Work.*—Gross income does not include amounts referred to in subsection (a) to the extent such amounts—

(1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent (as defined in section 152), and

(2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

(d) *Wage Continuation Plans.*—Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

(e) *Accident and Health Plans.*—For purposes of this section and section 104—

(1) amounts received under an accident or health plan for employees, and

(2) amounts received from a sickness and disability fund for employees maintained under the law of a State, a Territory, or the District of Columbia,

shall be treated as amounts received through accident or health insurance.

(f) *Rules for Application of Section 213.*—For purposes of section 213 (a) (relating to medical, dental, etc., expenses) amounts excluded from gross income under subsection (c) or (d) shall not be considered as compensation (by insurance or otherwise) for expenses paid for medical care.

(26 U. S. C. 1952 ed., Supp. II, Sec. 105.)

SEC. 106. CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS.

Gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for person injuries or sickness.

(26 U. S. C. 1952 ed., Supp. II, Sec. 106.)

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Supreme Court of the United States

OCTOBER TERM, 1956 No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES,
Petitioners,

v.

THE UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR JOSEPH OLIVA AS AMICUS CURIAE

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Supreme Court of the United States

OCTOBER TERM, 1956

No. 257

Gordon P. Haynes and Essie M. Haynes, Petitioners,

v.

The United States of America

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR JOSEPH OLIVA AS AMICUS CURIAE

STATEMENT OF JOSEPH OLIVA'S INTEREST AS AMICUS CURIAE

Joseph Oliva, *amicus curiae*, is the petitioner in the case of *Joseph Oliva* v. *Commissioner of Internal Revenue*, now pending in the United States Court of Appeals for the Third Circuit[1] on petition for review of the decision by The Tax Court of the United States in *Joseph Oliva*, 25 T. C. No. 153 (1956).

That litigation involves the taxability of Joseph Oliva on $1,133.10 received by him in 1949 pursuant to a disability benefit plan covering the employees of Esso Standard Oil Company, his employer, and affiliated companies. The outcome of the present case is expected to have a direct bearing on the disposition of such litigation, which

[1] Docket No. 12,038.

has been suspended pending decision here. The instant hearing is likely to provide the last practical opportunity which he will have for presenting his view that disability benefits paid by an employer to his sick and disabled employees, pursuant to a specific arrangement with them established for their protection against the economic risk of accident or ill health, are amounts received "through accident or health insurance" within the meaning of Section 22(b)(5) of the Internal Revenue Code of 1939. This brief is filed, therefore, in support of the petitioners.

SUMMARY OF ARGUMENT

I. There being no contrary indication, Congress presumably intended the term "insurance" to have its normal legal meaning. The legal concept of "insurance" is relatively simple. It consists of nothing more than a contract binding one party to indemnify another in the event of a specified loss. The risk is thus transferred by contract to the "insurer", the party protected is the "insured", and the transaction is "insurance". No particular words or other formalities are required, the matter being entirely one of substance.

II. Disability benefit plans protect employees from loss of earnings by reason of non-service-connected sickness or accident, and materially aid employers in securing and retaining better quality service from employees. Such plans represent one of the considerations of the employment, and the employees' services encompass the *quid pro quo* for the protection and benefits accorded them. Benefits are disbursed on a systematic basis under terms and conditions specifically established in the plan; and accrued rights thereto are non-cancellable.

The risk protected is that of the employee—a risk of loss of earnings through disability. This risk is trans-

ferred to the employer under the plan, and the latter may carry it himself or reinsure it to a varying extent with a commercial insurance carrier by purchase of a group policy specifically geared to the terms of the plan. In the latter case a tentative premium is ordinarily charged and at the end of the term a refund is made of the excess thereof over losses and expenses incurred. Thus only the risk of extraordinary or "non-statistical" incidence of disability, in excess of the premium deposit, is ordinarily transferred to the commercial carrier. The employer therefore functions as an insurer of the employees' risk to a large extent even where commercial coverage is procured, and entirely so where not procured.

At the same time the risk is distributed economically throughout the group of employees as a whole, for the employer assumes the risk of *all* in exchange for services *from them all* as a group. In the aggregate they provide the economic worth which justifies the plan financially, and those who are not disabled contribute services in consideration of the benefits paid those who are.

Since the arrangement is legally binding, it not only is insurance in economic function but also meets the simple requirements of the legal concept of "insurance"—*i.e.*, an undertaking to indemnify in the event of loss.

III. The Court of Appeals misconceived the nature of the plan and benefits paid thereunder. Disability benefits naturally are measured by reference to wages or salary, for their purpose is to replace earnings lost by inability to work. But they are the proceeds of a contract for insurance protection, and thus are not to be confused with mere voluntary wage continuations during sickness. The present benefits were *mandatory*, not "voluntary", and were required by an arrangement having all the essentials of an insurance contract. The court in the present case failed to analyze the legal concept of "insurance", and the facts of the particular arrangement,

sufficiently to determine whether such essentials were present. In its entire opinion it did not cite a single authority or source material in support of its own thinking, nor did it really formulate and apply to the facts involved any concrete meaning of the statutory exemption.

Rather it was preoccupied by formal considerations, and vague notions of statutory construction not specifically related to the issue—particularly the notion of "revenue loss". In the latter connection it clearly has mistaken the judicial function. Congress may or may not be greatly concerned with the potential revenue effect of an exemption, although it seems unlikely here; and in any event, this does not shed any specific light on the meaning of the term "insurance". Congress chose its terminology and this must be followed without regard to general fears of revenue cost, which is solely a legislative concern.

ARGUMENT

I. The Term "insurance" has a well-established meaning, and involves nothing more than a binding obligation of one party to indemnify another in the event of loss.

The Internal Revenue Code of 1939, which governs the present proceeding, provides for the exclusion from gross income of "* * * amounts received, through * * * health insurance * * *, as compensation for sickness." § 22(b)(5). The amount in dispute was clearly received by petitioner, pursuant to the terms and conditions of the disability benefit plan of his employer, Southern Bell Telephone & Telegraph Company, as compensation for sickness (R. 49). The only question, therefore, is whether the amount was received "through * * * health insurance".

The legislative history of Section 22(b)(5), which was first enacted as Section 213(b)(6) of the Revenue Act of

1918, offers no clue that Congress intended to impart a special meaning to the term "health insurance" as used in the statute.[2] Hence it must be presumed to have been used in its normal legal sense. See *Helvering* v. *Le Gierse*, 312 U. S. 531, 540 (1941). In the *Le Gierse* case, this Court had under consideration the meaning of the term "insurance" as used elsewhere in the same revenue act. Pointing out that the committee reports and hearings were "uninformative", the Court proceeded on "the assumption that Congress used the word 'insurance' in its commonly accepted sense."[3]

The "commonly accepted sense" of the term "insurance" is that it consists of an enforceable promise by the insurer to pay a certain sum to the insured upon the happening of a specified contingency, the purpose being to protect against potential loss. Webster defines insurance as "* * * a contract whereby, for a stipulated consideration * * * one party undertakes to indemnify or guarantee another against loss by a certain specified contingency or peril * * *." Webster's New International Dictionary 1289 (2d ed. unabridged, 1947). Health insurance is defined in the same work as "insuring a person against loss due to personal illness resulting in disability." *Ibid.*

Other authorities have defined insurance as a "contract whereby, for a stipulated consideration, one party undertakes to compensate the other for loss on a specified subject by specified perils", Black's Law Dictionary 943 (4th ed. 1951); or as a "contract whereby, for an agreed premium, one party undertakes to compensate the other for loss on a specified subject by specified perils", Bouvier's Law Dictionary 1613 (8th ed. 1914); or as "a contract by which one party for a consideration as-

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[2] See H. R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1919). The provision appeared unchanged in subsequent revenue acts and, as Section 22(b)(5), in the Internal Revenue Code of 1939. It was amended in 1942 in respects not relevant here. See Revenue Act of 1942, Secs. 113 and 127(d); Sen. Rep. No. 1631, 77th Cong., 2d Sess. 77, 96 (1943); H. R. Rep. No. 2586, 77th Cong., 2d Sess. 37 (1943).

[3] 312 U. S. at 538-540.

sumes particular risks of the other and promises to pay him or his nominee a certain or ascertainable sum of money on a specified contingency", 44 Corpus Juris Secundum 471 (1945); and the latter source defines health insurance as "an indemnity to persons for expense and loss of time occasioned by disease". *Id.* at 480.

It can be safely concluded that the "authorities are substantially agreed that insurance generally may be defined as an agreement by which one person for a consideration promises to pay money or it equivalent . . . to another on the destruction, death, loss, or injury of someone or something by specified perils", and that as "a general matter, the essential feature of policies of insurance at the present time is substantially that of indemnity to the insured." 29 Am. Jur. 47 (1940).

Thus, in basic legal concept "insurance" involves a relatively simple set of relationships, and should be readily recognized in a given situation. No further element beyond those described above is required, although reference is sometimes made to the pooling of common risks as being characteristic of insurance. See, *e. g., Helvering* v. *LeGierse*, 312 U. S. 531, 539 (1941). However, the latter is merely a frequent business or economic characteristic, rather than a *legal requirement*—as will be appreciated when it is realized that an insurance company creates what is "insurance" in law when it insures a dancer's legs, though the pair involved is unique and none other is insured by such company. The name of Lloyd's of London is virtually synonymous with "insurance", though Lloyd's has long specialized in contracts involving unique situations with little or no opportunity for pooling similar risks.

No particular formal requirements are necessary to insurance. The contract need not be in writing; no particular form of consideration by the insured is required; the insurer's obligation need not be secured by a fund or reserve; and the insurer need not be a commercial in-

surance company. See, *e.g.*, *Commissioner* v. *Treganowan*, 183 F. 2d 288 (2d Cir.), *cert. denied*, 340 U. S. 853 (1950). Conversely, as this Court determined in the *Le Gierse* case, compliance with every possible formality will not make insurance of that which is not. In other words, what constitutes insurance is a matter of substance, and that substance is a contract to indemnify against loss.

II. EMPLOYEE DISABILITY BENEFIT PLANS, SUCH AS THAT INVOLVED HERE, CONTAIN ALL THE ESSENTIALS OF INSURANCE; AND BENEFITS PAID THEREUNDER FALL WITHIN SECTION 22(b)(5) OF THE INTERNAL REVENUE CODE OF 1939.

Admittedly, the record in the present matter does not show, in an evidentiary way, the general nature of employee benefit plans and practices. However, the Court cannot decide the case in a vacuum of information on this subject. Accordingly, one of the principal purposes of this brief is to make sure that the Court has access to fundamental information in the field. An effort is made in the paragraphs which follow, in briefest terms, to put disability benefit protection in its proper context; and in Appendix A hereto there is provided for the Court a short bibliography from which more detailed information is available.

Essential Background Material

Disability benefit protection is distinguished from workmen's compensation protection in that the former compensates for loss of income resulting from non-service-connected disability, whereas the latter compensates for loss of income because of injury or sickness sustained in the course of employment. The principle of workmen's compensation, of course, reaches back into the last century, but it is also true that disability benefit plans of the general nature at issue here and in the *Oliva* case are by no means new.[4] The Telephone Company plan, here involved,

[4] See B. N. Armstrong, *Insuring the Essentials* 370 (1932).

originated in 1913 (R. 49, 56). The Esso Standard Oil Company plan dates back to 1918. Through the years coverage of this type has been extended until more than 39,000,000 workers throughout the United States are presently so protected by formal plans.[5] Moreover, in several states employee disability benefit protection is required by law.[6]

Disability benefit protection may be provided either on a "contributory" basis, *i.e.*, the covered employees make *cash* contributions toward its cost, or on a "non-contributory" basis, in which case they do not make such contributions.[7] Where disability benefit protection is required by law, as in New York, the statute may provide for a modest employee payroll deduction; but even there, a non-contributory plan may be, and frequently is, utilized and accepted as in compliance with the statute.

Despite the fact that disability benefit protection is frequently non-contributory, it would be unduly naive to regard it as something provided "free" to employees by their employers as a voluntary provision springing merely from generosity. The fact is that the cost of disability benefit protection, which runs into many millions, is a significant element of the sum total of economic emoluments exchanged by management with labor for its services.[8] Such protection is highly valued by employers for its beneficial influence on employee morale, efficiency and loyalty to the enterprise—that is, for the quality of the services it engenders. It is prized perhaps even more by employees for its measure of freedom from the fear of economic pressure induced by physical misfortune. Where shops are unionized, disability benefit protection is a

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[5] Health Insurance Council, *The Extent of Voluntary Health Insurance* 25 (1956).

[6] See, *e.g.*, Ch. 600, 1949 Laws of New York.

[7] See Final Report, Subcommittee on Welfare and Pension Funds, Committee on Labor and Public Welfare, S. Rep. No. 1734, 84th Cong., 2d Sess. 14 (1956).

[8] *Id.* at 6-7.

proper subject of collective bargaining;[9] and is considered together with vacation, retirement, medical and other "fringe benefits" in appraising the effective dollar compensation.[10] Invariably, the presence of a disability benefit plan is held out to attract and retain workers, who rely upon it in accepting and continuing employment.[11] It would be fatuous, therefore, to think of disability benefit protection as other than *paid for by the employee's service.*

It would be equally unrealistic to regard disability benefit protection as subject to cancellation or withdrawal at the employer's whim, either as to the employees as a whole or in individual cases. Once a plan is established, there is no turning back the wheel of progress, as a practical matter; and, as will be later demonstrated in this brief,[12] as a matter of legal obligation any benefits accrued—paid for by services—are in any event no longer subject to discontinuance or recall. Many plans in words preserve the employer's right of *prospective* discontinuance of the plan as such, although this may be suspended for a term by union contract; but in the event of discontinuance, it is normally likewise open to the employees to discontinue work, in favor of employment elsewhere on terms and conditions deemed more satisfactory.

Most disability benefit plans have a common structure: All employees are covered automatically[13] after

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[9] U. S. Department of Labor, Bureau of Labor Statistics, *Employee Benefit Plans Under Collective Bargaining*, (Bulletin No. 940) (1948); see also U. S. Department of Labor, Bureau of Labor Statistics, *Digest of One Hundred Selected Health and Insurance Plans Under Collective Bargaining*, (Bulletin No. 1180) (1955); United States Department of Health, Education, and Welfare, U. S. Public Health Service, *Management and Union Health and Medical Programs* (1953).

[10] See A. M. Ross, *Fringe Benefits Today and Tomorrow*, 7 Labor Law Journal 476 (August 1956); *Accident and Sickness Insurance* 10, 12 (McCahan ed. 1954).

[11] See, *e.g.*, *Hearings Before the Committee on Ways and Means on Forty Topics Pertaining to the General Revision of the Internal Revenue Code*, 83d Cong., 1st Sess. 370 (1953).

[12] *Infra*, p. 14 *et seq.*

[13] *Accident and Sickness Insurance* 115, 168 (McCahan ed. 1954).

having been employed a brief waiting period designed to eliminate coverage of floating or temporary personnel.[14] No physical examination is required for admission into the plan, although one is frequently required in connection with original employment. In the event of disability not covered by workmen's compensation, weekly benefits become payable, although only after a waiting period, ordinarily a week,[15] has expired—this to take minor illnesses out of the plan. The latter are variously treated, many employers permitting brief absences for known cause without cessation of pay.

Benefits payable are ordinarily measured by a percentage, sometimes varying with duration of disability, of regular compensation and may be as much as 100% of normal compensation.[16] Benefits are in most cases payable for a stated period of weeks, which may increase with service until, frequently, a full year's protection is available.[17] During the period of benefit payments the employee is subject to medical examination and supervision looking towards assurance of his recovery and return to service as quickly as possible.[18]

There are two basic methods of underwriting disability benefit plans. The persons "insured", *i.e.*, protected against loss of income through physical disability, are the employees. The employer assumes responsibility for this protection, thus transferring the risk to himself. He may then, to a greater or lesser extent, reinsure this risk by procuring an appropriate contract from a commercial insurance company. On the other hand, he may carry the risk entirely himself, in which event he is con-

[14] If the plan is a contributory one, eligibility, rather than coverage, is automatic.

[15] J. V. Strong, *Employee Benefit Plans* 312 (1951).

[16] *Ibid.*

[17] National Industrial Conference Board, Inc., *Studies in Personnel Policy: Health Insurance Plans—Company Non-Contributory Disability Benefit Plans* (1939).

[18] See *Accident and Sickness Insurance* 181 (McCahan ed. 1954).

sidered a "self-insurer". In some states, as in New York, a third method of underwriting is available, *i.e.*, through a state-operated fund which may be termed the "state-insured" plan.

It may surprise the uninformed to discover how little difference there is between the commercially insured and self-insured system.[19] The essential difference is that under the commercially insured plan, the employer ordinarily retransfers a portion—not all—of the risk to the insurance company. This portion, however, is not the usual or ordinary risk, but only the risk of epidemic or other catastrophe—the risk which rarely materializes.[20] This result is achieved through the device of adjustable premiums, or retrospective rating.[21] Under this system, the initial premium for the term is merely a deposit which is subsequently adjusted to cover actual losses and expenses, plus the insurance company's fee for servicing the plan; and the balance of the premium deposit is refunded. Such original deposit is ordinarily calculated to provide more than ample coverage for the anticipated cost, and refunds frequently amount to 30% or more of the deposit. Thus, the risk assumed by the insurance company is not the risk of the ordinary average volume of disability incidence among the group, but only the risk of an extreme degree of disability in the nature of catastrophe.

Employers commonly appreciate this and realize that under the commercially insured plan, as under the self-insured plan, they bear the really significant risk; they and not the insurance company actually pay the disability benefit disbursements; and they do so in the

[19] As stated by one commentator: "Group sickness and non-occupational accident insurance differs from company non-contributory and from joint employer-employee plans largely in that it is handled through an insurance carrier." E. Davis, *Company Sickness Benefit Plans for Wage Earners* 10 (Industrial Relations Section, Princeton University 1936).

[20] National Industrial Conference Board, Inc., *op. cit. supra* note 17.

[21] *Accident and Sickness Insurance* 116, 123, 177 (McCahan ed. 1954).

purchase of better services from their employees. A substantial percentage of disability benefit protection is, therefore, "self-insured".[22] The choice of this method is particularly suitable where the employee group is large, for the distribution of the risk is much wider and the likelihood of "non-statistical" disability incidence is greatly reduced. Moreover, a large group justifies the establishment by the employer of the necessary administrative machinery to operate the plan in much the same way as a commercial insurance company would, and the insurance company is sometimes deemed unable to offer a service that the company cannot provide more cheaply for itself.[23]

If one were to examine the work methods and procedures utilized in the administration of a self-insured plan, it would immediately appear to have the characteristic features of an insurance company operation. The records would be kept, the medical supervision carried on, the cost actuarially calculated, malingering controls exerted, etc., all in accordance with standard insurance company techniques. Indeed, it is not unusual where such a program exists for an insurance company to "insure" the plan but leave its operation to the employer, including the drawing of checks on the insurance company to pay benefits.[24] In such a case, the function of the insurance company is merely to receive the premium deposit, refund the balance at the end of the term, and assume liability for theoretical costs in excess of the premium. It is a matter of business judgment whether the presence of a regular insurance company in such a case is of sufficient advantage to justify the fee charged. Such advantage includes possible greater confidence in the plan on the part of em-

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[22] National Industrial Conference Board, Inc., *op. cit. supra* note 17.

[23] *Hearings Before the Committee on Ways and Means on Forty Topics Pertaining to the General Revision of the Internal Revenue Code, op. cit. supra* note 11, at 367.

[24] See Final Report, Subcommittee on Welfare and Pension Funds, *op. cit. supra* note 7, at 32.

ployees, possible lesser likelihood of abuse on their part, protection of the corporate management from possible criticism in the event of catastrophe losses, etc. On the other hand, the advantages of self-insurance include lower cost, closer employee-employer relationship, and greater appreciation by the employee of the benefits provided.

With this background, the question whether disability benefits, however financed, are received "through accident or health insurance" may be better approached. Several major characteristics of disability benefit protection immediately stand out:

1. In all cases the risk against which a disability benefit system provides protection is the employee's loss of income on account of disability.

2. This risk, and the loss if it materializes, are the employee's risk and loss.

3. The employee pays for his protection against such risk with an economic *quid pro quo* in the form of his services.

4. The risk is transferred to the employer, who may carry it entirely himself as a "self-insurer", or transfer a part of it to a commercial carrier.

5. In the latter event, there ordinarily is transferred in fact only the less significant portion (catastrophe) of the risk.

6. Finally, it is only the presence of the group of employees, within which the risk is distributed, that makes the system economically practicable. That is, the employer assumes the risk of *all* members of the group in exchange for service *from all*. However, only a few in the group will sustain a loss of income from disability and be paid the protective benefits. Accordingly, all members contribute services in order to provide an aggregate of economic worth which will finance the protection of all and the benefit payments to the few who are disabled. Each employee thereby

contributes to the loss of those disabled; and the risk is thus distributed among the group and transferred to the employer who either carries it as a "self-insurer" or retransfers it, to a greater or lesser extent, to a commercial carrier.

All the foregoing is plain, recognizable fact, unassailably true, which would not be seriously disputed by anyone familiar with the field. It should be kept firmly in mind in appraising the legal questions presented by this appeal.

Disability Benefit Protection is "Insurance"

Looking at disability benefit plans generally, and at the Southern Bell plan in particular, one may readily see that such plans fit squarely into the traditional concept of insurance obligations. Physical disability preventing work is a contingency involving potential loss of income. Upon the occurrence of this contingency, a cash benefit, specifically designed to mitigate or eliminate the loss, becomes payable pursuant to the provisions of a carefully worded agreement. The agreement reflects a business arrangement, binding in character and paid for with services, actually set up with the sole purpose of creating the crucial relationship of insured and insurer, within the legal concept of insurance developed above. Nothing is missing, and only one answer is possible.

One must, of course, analyze the arrangement, as is done below, to make sure that it is a contract, that there is binding consideration for it, that the subject is protection against the risk of loss, and that an indemnity is provided therein. But if these are all present, as we submit they are, a finding of "insurance" is inescapable.

Perhaps the most striking aspect of the plan in issue is the careful and lawyer-like fashion in which it is drawn. Obviously it is the product of highly skilled and thoroughly competent legal counsel. And it is equally obvious that it was intended to create enforceable rights

and duties, primarily the payment of specific benefits in the event of disability. The very first sentence of the plan provides that the Company "*undertakes* * * * to provide for the payment of definite amounts to the employees when they are disabled by * * * sickness * * *" (R. 62). This is the language of legal obligations, not of gratuitous benefits. Throughout the plan a careful distinction is made between mandatory and discretionary provisions, as indicated by the use of the words "shall" or "may", or by reference to the "discretion" of Company representatives. It is flatly provided that "the sickness disability benefits * * * *shall* be as follows * * *", and a detailed schedule of benefits is then set forth (R. 72). Again, "Sickness disability benefits *shall* begin on the eighth calendar day of absence on account of disability * * *" (R. 72). (Italics added.)

Finally, section 10 of the plan, entitled "Changes in Plan", provides as follows:

> "The Committee * * * with the consent of the President and subject to the approval of the Board of Directors, may from time to time make changes in the Plan set forth in these Regulations, and the Company may terminate said Plan, *but such changes or termination shall not affect the rights of any employee, without his consent, to any benefit or pension* to which he may have previously become entitled hereunder." (R. 88). (Italics added.)

This provision is sufficient in itself to eradicate any doubt as to whether disabled employees have enforceable rights.

The requirement of consideration is readily met by the services so faithfully rendered by petitioner over a period of more than twenty-five years (R. 49). That it was assumed that the plan constitutes an integral feature of the employment contract and that the employees render their services, in part at least, in reliance on the benefits

of the plan can hardly be questioned in view of the express provision for the distribution of a copy of the plan to each employee upon commencement of his employment with the Company (R. 61). The courts have long recognized that the consideration furnished by the employees in the form of their services is in part given for the so-called fringe benefits, including disability protection, provided by the employer and that the obligation which the employer assumes under a disability benefit plan is one which he cannot escape by asserting that the benefits are gratuitous.

The case of *Cain* v. *Allen Electric & Equipment Co.*, Mich. , 78 N. W. 2d 296 (1956), is squarely in point. There the defendant employer had adopted a "supervisory and office personnel policy" which hardly rose to the dignity of a comprehensive plan, such as the one here involved. The "policy" provided, *inter alia*, for the payment of a specified amount as severance pay, but this provision, like all others, was expressly made subject to change by the employer without any specific reservation of accrued rights. Nevertheless, the court firmly rejected defendant's contention that its declarations of personnel policy were not of a contractual or promissory nature, and instead held that the company was bound by its announced policy. The court stated:

> "We cannot agree that all we have here is a mere gratuity, to be given, or to be withheld, as whim or caprice might move the employer. An offer was made, not merely a hope or intention expressed. The words on their face looked to an agreement, an assent. The co-operation desired was to be mutual. Did the offer consist of a promise? A promise is an expression of intention that the promisor will conduct himself in a specified way or bring about a specified result in the future, communicated in such manner to a promisee that he may justly expect performance and may reasonably rely thereon. (Corbin on Con-

tracts, Section 13). The essence of the announcement was precisely that the company would conduct itself in a certain way with the stated objective of achieving fairness, and we would be reluctant to hold under such circumstances that an employee might not reasonably rely on the expression made and conduct himself accordingly. As for consideration, that element setting apart the enforceable from the unenforceable, we hazard no definition. Suffice in this respect, upon the authority of a multitude of cases, to point out that not only were there rewards to the employee, but, in addition, substantial rewards to the employer, arising, in part, out of the accomplishment of the daily work of the organization in a spirit of co-operation and friendliness. In short, the adoption of the described policies by the company constituted an offer of a contract. This offer, as the trial court correctly held, 'the plaintiff accepted * * * by continuing in its employment beyond the five-year period specified in Exhibit B (the Termination Pay Policy).' The offer having thus been accepted, it was not within defendant's power to withdraw it when called upon to perform. The 'change or amendment' to which the company policy was said, in its preamble, to be subject, could not encompass denial of a contract right gained through acceptance of an offer. To assert otherwise is simply to reassert that there was no contract." 78 N. W. 2d 296, 300-301.

So also in *Chinn* v. *China National Aviation Corporation*, 138 Cal. App. 2d 98, 291 P. 2d 91 (1955), it was held that employee benefit plans of the type with which we are here concerned constitute, technically, offers for unilateral contracts in which the acceptance contemplated is the continued performance of services. In that case the defendant employer adopted regulations providing employee benefits in the nature of severance pay

which amounted to more than $10,000 for an employee in plaintiff's position. Plaintiff, who had previously advised defendant of his intention to terminate his employment forthwith, postponed such action in order to qualify for the newly adopted benefits. The Court sustained his claims, describing the nature of the contract as follows:

> "Of late years the attitude of the courts (as well as of employers in general) is to consider regulations of this type which offer additional advantages to employees as being in effect offers of a unilateral contract which offer is accepted if the employee continues in the employment and not as being mere offers of gifts. They (make) the employees more content and happier in their jobs, cause the employees to forego their rights to seek other employment, assist in avoiding a labor turnover, and are considered of advantage to both the employer and the employees." 138 Cal. App. 2d 98, 99-100, 291 P. 2d 91, 92.

As long ago as the year 1912 it was judicially recognized that fringe benefits tend "to induce employees to remain continuously in the employ of the same master and to render efficient services * * *." *Zwolanek* v. *Baker Manufacturing Co.*, 150 Wis. 517, 521, 137 N. W. 769, 771 (1912).

And similarly in 1922 the Supreme Court of North Carolina stated:

> "It has become a very general policy with large employers of labor to offer a bonus or additional compensation to employees who shall render continuous and efficient service for a specified period of time. This is not a gratuity or gift, but is an offer on the part of the employer, with whom the offer originates in order to procure efficient and faithful service and continuous employment, and when the employee enters upon the service upon that in-

ducement it becomes a supplementary contract of which he cannot be deprived without sufficient cause." *Roberts* v. *Mays Mills*, 184 N. C. 406, 410, 114 S. E. 530, 532 (1922).

This doctrine has also been explicitly applied for income tax purposes, justifying the accrual by an employer of an undistributed, but customary, annual bonus. *Willoughby Camera Stores, Inc.* v. *Commissioner*, 125 F. 2d 607 (2d Cir. 1942).

Indeed, so strong is the doctrine of contract through inducement and reliance in these situations that it has prevailed even though the benefits listed in an "Employee Handbook", which was circulated among the employees, were expressly made subject to discontinuance. *Hercules Powder Co.* v. *Brookfield*, 189 Va. 531, 53 S. E. 2d 804 (1949).[25]

Apparently the Commissioner appreciates the significance of petitioner's contractual right to disability benefits, for he argued below against the existence of any such right, relying on two sections of the plan. These are section 3(3), providing that the committee "shall determine conclusively for all parties all questions arising in the administration of the Plan" (R. 63), and section 8(1) (R. 79), providing, *inter alia*, that no employee has "any right against the Company to any benefit under the Plan other than the amount to which the employee has theretofore become entitled and which the Committee has directed to be paid to that employee under the Plan." Obviously, these provisions relate solely to the administration of the plan and do not empower the committee to dissolve substantial rights of the employees. Section 3(1) clearly so indicates by providing the "Committee shall be charged

[25] Other cases reaching a similar result are Hurd v. Illinois Bell Telephone Co., 30 CCH Lab. Cases ¶ 70,067 (7th Cir. 1956); Psutka v. Michigan Alkali Co., 274 Mich. 318, 264 N. W. 385 (1936); Mabley & Carew Co. v. Borden, 129 Ohio St. 375, 195 N. E. 697 (1935); Kristt v. Haire, 155 N. Y. S. 2d 362 (Sup. Ct. 1956); Hunter v. Sparling, 87 Cal. App. 2d 711, 197 P. 2d 807 (1948).

with the administration of the Plan" (R. 63). Moreover, if this were not so, the entire carefully constructed scheme of benefits, couched in mandatory language, would be wholly meaningless. The second provision relied upon by the Commissioner (Section 8(1)) by its own terms preserves accrued rights (R. 79); and the Company's ability to terminate or change the plan *prospectively* is of no consequence with respect to the status of benefits no longer subject to cancellation. As a matter of fact, a cancellation clause, operating prospectively, is a common provision of commercial health insurance policies.[26]

Moreover, even if the committee had the power to alter the benefits payable, this would, nevertheless, not be inconsistent with the existence of contractual rights. For the committee and the Company are not identical entities, and there is no indication that the committee could or would act in the interest of the Company alone. Rather, in the absence of an express provision to the contrary, it would have to act impartially and fairly, as a quasi-fiduciary, in deciding the questions with which it might be confronted. It is, of course, a well established principle of contract law that a contract may validly delegate to a third party the duty to measure the consideration to be furnished. This rule is succinctly set forth in the Restatement:

> "A bargain in which the only measure of a promisor's duty is whatever valuers or arbitrators shall decide is not illegal unless its terms under the circumstances are unfair." RESTATEMENT, CONTRACTS, Section 551(3) (1932).

All that has been said to the contrary notwithstanding, should the Commissioner nevertheless insist that the plan does grant the committee as agent of the Company the sole power to determine whether any disabled and quali-

[26] R. W. Osler, *Guide to Accident & Sickness Insurance* 55-56, 68-69 (rev. ed. 1955).

fying employee shall receive any benefits at all, the plain answer would be that such a provision would be wholly void. It would give the Company the right to be the judge in its own case, and such provisions have traditionally been held invalid on the ground that they offend public policy. See, *e. g., Wallace* v. *Brotherhood of Locomotive Firemen and Engineers,* 230 Iowa 1127, 300 N. W. 322 (1941).

We have previously mentioned the association of "risk distribution" with insurance, pointing out that it is a common characteristic but by no means a legal necessity. The Commissioner attempted to make something of this below, contending that although the employees shifted the risk of sickness to the Company, the burden of that risk was not borne ratably by all employees, nor ratably by the Company and other employers similarly situated.

It may be noted that the Commissioner concedes tax exemption to amounts received under a commercially insured plan, although we have already pointed out that there is no greater or different transfer or distribution of risk under such a plan, except with respect to the relatively unimportant risk of catastrophe or other extreme non-statistical incidence of disability. (See p. 11, *supra.*) Accordingly, even the Commissioner—if he were right in his contention that there is none in the self-insured plan—would not really require risk distribution. In this connection he would be in good company, for (as also previously pointed out at p. 6, *supra*) commercial insurers generally consider a shift of risk, even if not accompanied by any appreciable risk spreading, as insurance.[27] No one in the insurance world would for a moment doubt that Lloyd's insurance of the dancer's legs was "insurance".

Apart from this, the economics of the plan here involved does present a plain case of risk distribution. As heretofore established, there is a binding contract implicit in this plan and the circumstances surrounding it. The consideration furnished by each employee in-

[27] *Id.* at 110, 133.

the form of continued or more effective service is, both conceptually and realistically, the economic equivalent of a cash premium paid by him. This is his proportionate share of the cost of protection against illness for all employees. The cost of mitigating the danger of potential loss due to illness is thus spread throughout the entire employee group.[28]

Stated differently, each employee's risk that he might suffer loss as a result of disabling illness is pooled with the similar risk of all other employees, and the employer, as insurer, brings together these risks and provides the desired protection in consideration of the services rendered to him by all the employees. By furnishing his part of this consideration each employee contributes economic worth which *in toto* procures the group protection; and he thus contributes to the loss of any disabled person in the group as fully as if he had paid cash of equal worth. The cost per employee of the protection so provided is small because the relatively few cases of protracted illness are balanced by the large number of employees who do not become ill at all or are ill only for very brief periods. In short, the risk of disability due to illness in the present case was shifted from the petitioner (the insured) to the Company (the insurer); and the cost or premium was distributed ratably among all of the Company's employees.

The Court should understand that characterization of disability benefit plans as "health insurance" for purposes of Section 22(b)(5) is by no means a novelty concocted by ingenious counsel for purposes of this litigation. As previously described, plans of this kind date back 40 years or more; and only in relatively recent times has the Commissioner sought to tax the benefits. As late as 1950 the Commissioner publicly expressed the view that a binding obligation to make stipulated payments to an

[28] *Cf. Commissioner* v. *Treganowan*, 183 F. 2d 288, 291 (2d Cir.), *cert denied*, 340 U. S. 853 (1950).

employee in the event of non-service-connected disability constitutes health insurance within the meaning of the statutory exemption. Thus, in ruling upon this issue in connection with a disability benefit plan adopted in accordance with provisions of the California Unemployment Insurance Act the Commissioner said:

> "A voluntary[29] plan which has been approved by the California Employment Stabilization Commission, constitutes a contract of insurance. Such a plan, adopted under the compulsion of State law, is a contract between the employer and his employees which obligates the employer to pay, and entitles the employees to receive, fixed amounts of compensation for personal injuries or sickness for a fixed period. The employees' rights to receive benefit payments under a voluntary plan in consideration of their employment, and the employer's obligation to pay the benefits satisfy the requirements of contract. Furthermore, it seems clear that the contract is one of insurance, as a voluntary plan assures and promises each qualified employee a fixed compensation for a fixed period in the event accident or sickness renders him unable to work. Such assurance is the basic function of an insurance contract. Therefore, such a plan also meets the requirements of Section 22(b)(5) of the Code." I.T. 4015, 1950-1 Cum. Bull. 23, 25.[30]

The only material respect in which the employee disability plan covered by the foregoing ruling differs from the one now before the Court is that the plan was,

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[29] "Voluntary" in the sense that the statutory requirement of disability benefit protection in California is satisfied by an adequate plan voluntarily established by the parties in lieu of statutory benefits. California Unemployment Insurance Act § 450 *et seq.*

[30] I.T. 4015, 1950-1 Cum. Bull. 23, was modified by I.T. 4107, 1952-2 Cum. Bull. 73, but since in the latter ruling it was expressly assumed that the "employer has the sole discretion to determine who shall receive benefits," it can have no bearing upon the present case.

in the words of the Commissioner, "adopted under the compulsion of State law". If, as determined by the Commissioner, a contract supported by proper consideration existed under those circumstances, the present case would, *a fortiori,* involve a contract of insurance for, obviously, it is more difficult to conclude that a transaction constitutes a contract where there is an element of compulsion, than in its absence. Thus, it appears that in the only published ruling in which the Commissioner has really touched upon the essential nature of insurance, he was forced to conclude that disability benefits received pursuant to the provisions of an employer-insured plan are received through health insurance within the meaning of Section 22(b)(5).

The first Court of Appeals to speak on the subject agreed with the Commissioner's reasoning, as announced in the foregoing ruling. *Epmeier* v. *United States,* 199 F. 2d 508 (7th Cir. 1952). In a thoroughly persuasive opinion the court there held on facts closely analogous to those of the present case that payments pursuant to an employee disability benefit plan were "amounts received * * * through * * * health insurance", within the meaning of Section 22(b)(5). The court refused to be led astray by matters of form and, recognizing the basic function and purpose of the plan, unanimously concluded that insurance was involved.[31]

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[31] Other cases dealing with the issue here involved and reaching a result favorable to the taxpayer are *Adams* v. *Pitts,* 140 F. Supp. 618 (E. D. S. C. 1956); *Tinsley* v. *United States,* 56-2 USTC ¶ 9604 (W. D. Okla. 1956); *Priebe* v. *United States,* 56-1 USTC ¶ 9478 (D. Ariz. 1956), and *Herbkersman* v. *United States,* 133 F. Supp. 495 (S. D. Ohio 1955).

The only other opinion of a Court of Appeals dealing with the present issue is that of the Ninth Circuit in *Moholy* v. *United States,* 56-2 USTC ¶ 9745 (9th Cir. 1956). While the case is clearly distinguishable in that there the disability benefits were received by a city employee pursuant to the provisions of a city and county charter and local ordinances and regulations, not under a contract freely entered into by employee and employer, the court ignored this distinction. In holding that the disability payments were not exempt from tax under §22(b)(5), the court gave a great variety of rea-

In the absence of illuminating legislative history, it seems highly probable to us that the court in the *Epmeier* case put its finger on the Congressional purpose when it said that the statute was "undoubtedly * * * intended to relieve a taxpayer who has the misfortune to become ill or injured, of the necessity of paying income tax upon insurance benefits received to combat the ravages of disease or accident." (199 F. 2d 508, 511.) It is in no way apparent how this purpose would be served by drawing an artificial line between commercially-insured and privately-insured arrangements, and it seems inconceivable that Congress should have intended either (*a*) to impose a discriminatory tax upon disabled taxpayers, such as petitioner here, whose employer in the exercise of sound business judgment has chosen to administer an employee health insurance program himself, rather than delegate its administration to a commercial insurance company; or (*b*) to channel all such plans into the hands of commercial insurance companies by turning the weapon of severe tax penalties against privately-administered plans. Moreover, the whole tenor of Section 22(b)(5) rejects any such narrow distinction, for it is clearly comprehensive in scope, exempting not only amounts received through health insurance as compensation for personal injury or sickness, but also workmen's compensation payments and damages received on account of personal injuries. Congress quite plainly sought to soften the unexpected blow of disabling injury or disease, and in this spirit could not have intended to deprive privately-insured plans of such treatment.

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sons, but not once in its opinion did it address itself to the fundamental question of what constitutes insurance.

Other cases sustaining the Commissioner with respect to the taxability of employee disability benefits are *Cary* v. *United States*, 141 F. Supp. 750 (D. Neb. 1956); *Hanna* v. *United States*, 56-2 USTC ¶ 9736 (N. D. Tex. 1956); *Gamble* v. *United States*, 56-2 USTC ¶ 9666 (S. D. Tex. 1956); *Townsend* v. *United States*, 56-2 USTC ¶ 9813 (S. D. Ill. 1956); *Branham* v. *United States*, 136 F. Supp. 342 (W. D. Ky. 1955); *Joseph Oliva*, 25 T.C. No. 153 (1956); *Milton W. McQueen*, 15 CCH Tax Ct. Mem. Dec. 21,797(M) (1956).

In other areas of the Internal Revenue Code the courts, as well as the Commissioner, have looked to the nature of insurance, not to its commercial or formal characteristics, in order to determine whether a particular arrangement constitutes insurance within the meaning of a particular statutory provision. That this Court, in determining what constitutes "insurance", has not been impressed with the formal attributes of a purported policy of insurance is forcefully demonstrated by its unanimous opinion in *Helvering* v. *Le Gierse*, 312 U. S. 531 (1941). The Court there had no difficulty in holding that the "mere presence of the customary provisions" of an insurance policy cannot provide the answer to the question whether or not insurance is involved. Nevertheless, the Commissioner here urges little more than that the mere absence of the "customary provisions" of a commercial insurance policy is decisive of the present controversy.

Though the Commissioner apparently has chosen to ignore the teaching of the *Le Gierse* case, the lower courts have repeatedly relied upon it in adopting a realistic approach to the problem of defining insurance. Thus, in *Commissioner* v. *Treganowan*, 183 F. 2d 288 (2d Cir.) *cert. denied*, 312 U. S. 853 (1950), the court held that a plan under which each member of a group was entitled to a death benefit of $20,000 and was obligated to contribute $15 to a like benefit upon the death of any other member constituted insurance. It analyzed the concept in terms of its essential elements of risk or fortuity, rather than by reference to formalistic folderol.[32] That the fortuity there was death, whereas here it is sickness, cannot affect the result. Nor could the meaning of insurance be affected by the fact that there it was the Commissioner who urged a recognition of the substance of the transaction, while here it is the taxpayer. And, incidentally, in view of the Commissioner's present insistence upon the existence of a separate fund as a vital

[32] *Cf. Knight* v. *Finnegan*, 74 F. Supp. 900 (E.D. Mo. 1947).

ear-mark of insurance, it is interesting to note the court's recognition in the *Treganowan* case that, historically, insurance was not funded and that non-funded plans of risk shifting and distribution "have always been understood to be insurance * * *."[33] Indeed, Judge L. Hand suggested in a separate opinion dissenting on another aspect of the case that the presence of a separate fund reduced the similarity to insurance.[34]

The Tax Court has also followed the *Treganowan* approach to the matter. See *William E. Edmonds*, 16 T. C. 110 (1951). In holding the death benefit plan there involved to be life insurance the Tax Court made it plain that deviation from the universal customs of commercial life insurance could not affect the result, for it specifically found that there was "no plan of [commercial] life insurance in existence" which contained identical provisions.[35] Similarly, the Commissioner conceded that a municipally financed employee death benefit was insurance for purposes of the estate tax in the case of *Kernochan* v. *United States*, 29 F. Supp. 860 (Ct. Cl. 1939), *cert. denied*, 309 U. S. 675 (1940).

III. THE COURT BELOW MISCONCEIVED THE NATURE OF THE PLAN AND OF THE CONGRESSIONAL PURPOSE IN ENACTING THE STATUTE, AND TOTALLY IGNORED BOTH THE ECONOMIC AND LEGAL MEANING OF THE TERM "INSURANCE."

The opinion of Circuit Judge Brown, dissenting below, inspires immediate confidence because it displays some practical knowledge of the subject matter. The majority opinion, in contrast, is immediately suspect because it discloses several rudimentary misconceptions as to

[33] 183 F. 2d 288, 291.

[34] 183 F. 2d 288, 293.

[35] 16 T.C. 110, 115. *Cf. William J. O'Shea*, 47 B.T.A. 646 (1942), in which the Board, in holding an annuity not to be insurance, stated: "Nor is the fact important that the obligor on the contract was the [Teachers' Retirement] System and not an insurance company." 47 B.T.A. 646, 652.

what disability benefits are and how they are provided. Even more distressing, these very misconceptions seem greatly to influence the conclusions reached. The majority opinion (R. 103 *et seq.*) is relatively brief, and we believe it will be most enlightening to examine it paragraph by paragraph.

The issue is stated in the first paragraph. The second is confined to several generalities about statutory construction in the tax field, the substance of which is that the boundaries of tax inclusion and exclusion are fixed by Congress, not the courts, and must be so applied. This rule is doubtless acceptable to both parties here.[36]

In the third paragraph of its opinion the court quotes the statute, and then reveals its first thought on the issue, saying that the taxpayer seeks exemption of an amount "which in fact comes to him as a continuation of his regular salary during sick leave". The court thus freely equated the benefits paid with salary which an employer might voluntarily continue to pay an employee who is unable to come to work because of illness. In so doing the court disclosed its failure to grasp the real nature of a disability benefit plan.

Disability benefit insurance is *income* protection. Its very purpose is *to replace salary payments* which are lost. There should be no surprise, therefore, that the benefit payments bear some resemblance to the beneficiary's "regular salary"; or that their receipt is ultimately traceable to his having rendered services. However, the thing which is earned by the employee's services is the protection afforded by the plan itself, which gives

[36] The notion of "revenue loss" is first introduced in this paragraph, but nothing specifically is made of it *vis-a-vis* the issue at hand; and in the sixth paragraph of the opinion there is a vigorous denial that any "such loss has any part in enabling the Court to construe a statute." One must be careful when thinking in terms of "lost revenue." Probably the most serviceable concept of a "revenue loss" is the sacrifice of a measure of revenue which the fisc *has previously been enjoying*. It has been only in recent years that the Treasury has attempted to tax benefits of the kind here involved—so that it more properly should be regarded as seeking *revenue expansion*, rather than preventing revenue loss.

the employee vested rights to payments in the event of personal misfortune. These rights are what he earns, and which constitute a "fringe benefit" in addition to his salary, just as the employer's payment of a premium to an insurance company for similar rights would be. The payments received by the employee under the plan are simply a realization upon such rights or, in other words, the collection of insurance, just as would be his collection of the same sums from an insurance company. It is a mistake, therefore, to confuse the benefit payments with his "regular salary".

The difference which the court overlooks, of course, is that wages are paid for the performance of services, and disability benefits are paid because the disabled employee has a right to them under a contract of insurance and such right accrues because of *inability* to render services. No employee will ever receive such payments while he is performing services for the Company, no matter how many years he has rendered services and no matter how diligently and faithfully he has done so. Only if he does *not* render any services, due to disability, will he become entitled to the benefits; and as soon as the disability terminates the payments will terminate as well.[37]

Beyond the foregoing, no distinction between wages and sickness benefits is necessary or, indeed, appropriate, for the very purpose and function of health insurance, as pointed out above, is to provide benefits which will resemble as closely as practicable the income which has been lost as a result of the disability. As stated by the president of a large insurance company:

> "The prime purpose of disability insurance is to replace income lost to the worker who has been incapacitated through accident or sickness. The need of some social device for the continuance of income

[37] The plan specifically provides that "Employees shall not be entitled to receive sickness disability benefits for time for which any wages are paid them by the Company" (R. 73).

during disability has long been recognized and stems directly from the very wide dependence on earned income by the individual and his family. The importance of current earning ability of the breadwinner to the average family cannot be over-emphasized."[38]

and again:

"Disability insurance finds its useful function in continuing the income for the insured during the time when, by reason of illness or injury he is unable to earn."[39]

In the fourth paragraph of its opinion the court speaks of the plan as "voluntary"—a clearly erroneous characterization unless intended to mean nothing more than that the establishment of the plan was not required by statute. Contracts (insurance or otherwise) are normally voluntarily made, but this does not detract from their enforceability; and it is clear that the benefit payment at issue was a legal obligation of the Company.

In the same paragraph the court states that "it cannot be disputed that there is no separate contract or agreement of insurance". This is a concession to which the court is plainly not entitled. As we have developed at some length already, the whole disability benefit plan was exactly that—a contract or agreement of insurance—and this fact cannot be hidden by gratuitously asserting that "it cannot be disputed" that there was no such contract or agreement. If the stress was intended to be on the word "separate", we ask "separate" from what? The plan itself is the insurance contract, and it certainly seems "separate" enough. Further, why and whence this need for "separateness"?

The final sentence in the paragraph asserts that Congress had in mind payments "definitely and with binding

[38] Accident and Sickness Insurance 16 (McCahan ed. 1954).
[39] *Id.* at 18.

force fixed by an insurance contract between the employe and an insurer. * * *" No specific evidence is offered that this was in fact the "concept" of Congress, but in any event all elements of it are present here. The plan represented an insurance contract which with binding force fixed specific amounts to be paid ($2,100) to petitioner, and under which the Company was the insurer and the petitioner the insured.

In the next (fifth) paragraph of its opinion, the court attributes to the Congressional mind—again without specific evidence—a "clearly defined class" which is "readily identified" by having "attributes or characteristics associated with the term 'insurance' ". This class, the court continues, consists of those "who, for a definite consideration, having an actuarial relation to the benefits provided, paid by them or on their behalf, obtained insurance coverage under ordinary insurance standards". This test seems to come perilously close to insisting that the parties deal with a commercial insurance company[40]—and it is quite a bit to distill out of a single word ("insurance") without pointing to a shred of statutory language, legislative history, or judicial precedent in support of such meaning. This from a court which has opened its opinion with a strong condemnation of "judicial legislation" and "judicial fiat"!

The court thus announces a test of its own making, but totally fails to see that the present situation passes it with flying colors. The court did point out the respects in which it apparently thought the plan did not measure up to its test. It spoke of the payments as "payments of salary or wages by the voluntary action of his employer during sick leave"—although the payments were no more "voluntary" than in the case of any other insurance; and were not salary or wages, but benefit payments designed

[40] Congress could never have intended any such thing, for it would have penalized privately-insured plans and subsidized commercial insurance companies in a most outrageous manner. See page 25, *supra*.

to compensate for loss of income when salary or wages could not be earned.

There was mention also of some evidence (dubious) in the trial court that commercial carriers do not ordinarily insure 100% of income. This, of course, is a matter of premium cost; and there are few situations in the insurance field where full coverage is not available if one is a good moral risk and is willing to pay the necessary premium. Even the plan in question provided a benefit equal to full pay for a year only if the employee had 25 years' service with the Company (R. 72)—ample consideration, and excellent evidence of a sound moral risk.

The court also pointed out that the payments were not made "on an actuarial basis in relation to the amount of risk or to any other factor of age, state of health, or anything else". This is, indeed, an amazing comment! Obviously, the payments were made in exactly the same circumstances, for exactly the same reasons, and in exactly the same amount as would have been the case if a commercial insurance carrier had issued a policy to the Company and made the payments to the petitioner, using the Company's premium deposit for the necessary funds. The cost was as fully subject to actuarial computation as if a commercial insurance carrier were involved; and the Company doubtless knew better than an insurance company the cost of this *quid pro quo* which it was willing to give for services rendered.

In group insurance, as most everyone knows, the health of particular members of the group is normally disregarded, freedom from "insurability" being a principal advantage of such insurance.[41] The ages and sex

[41] As stated in Accident and Sickness Insurance at 115 (McCahan ed. 1956) ". . . group insurance is usually issued without any requirement of evidence of insurability from the individuals to be insured. Evidence of insurability can be waived because the individuals who are eligible for the insurance are bound together as a group by some strong interest other than that of obtaining insurance. As one would expect from general considerations, experience has shown that the natural interest of the employer in selecting efficient employees acts as a method of selection of lives so that the insured group will usually have normal and predictable morbidity."

of the employees were, of course, known to the Company; and statistical data on disability incidence are freely available to anyone interested. Add to this the Company's own experience with this group and plan for more than 35 years, and one inescapably wonders how a realistic court could assume that the probable cost was unknown to the Company or that it was not determined in the same way (in fact, the only possible way) as would have been done by a commercial insurance carrier.[42]

Further, it is stated that "no reserves were set up as is ordinarily done in the case of insurance"—but the solvency of the Telephone Company (the *raison d'être* for legally required insurance reserves) is not questioned, and may be safely assumed. Finally, it is stated that the "benefits were voluntarily fixed by a management committee"—a plain misconception of fact, as the benefits were specifically and expressly scheduled in the plan and were mandatory in character (R. 72).

To cap all this, the court itself observes in this same fifth paragraph that these indicia are cited "not to prove that the Company's plan here was unlike insurance"—as, indeed, they surely do not prove. What, then, makes the court feel that its own test of "insurance" is not satisfied? It offers nothing further, and it is more than clear that petitioner paid a "definite consideration"—services rendered for more than 25 years; that he obtained "insurance coverage"—contractual indemnity against loss; and that all this met "ordinary insurance standards"—indeed, could all have been readily reinsured with a commercial carrier, if the Company had so desired, without change of substance.

In this fifth paragraph and in the sixth the court speaks again of "loss of revenue", seemingly reasoning that Congress would not grant an exemption without

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[42] Moreover, actuarial computation of cost is not an indispensable element of insurance. See, *e.g.*, *General Life Insurance Co.* v. *Commissioner*, 137 F. 2d 185 (5th Cir. 1943); *cf.* G.C.M. 5921, VIII-1 Cum. Bull. 179.

knowing specifically what it would mean in terms of revenue sacrifice; and that it, therefore, must have had a concept of the exemption in mind so definite as to make measurement of the "lost" revenue possible. Even if a valid hypothesis—which is extremely doubtful—this in itself does not assist in identifying the particular supposed Congressional concept; nor is it even evidence that a court-invented narrow concept is more likely to be correct than a taxpayer-invented broader concept, the revenue implications of both being equally capable of estimation. Other evidence would be needed to ascertain whether Congress intended the broad or the narrow.

We cannot escape the belief that Judge Tuttle, by reason of experience with revenue legislation formulated in times of budgetary stress, has instinctively sought to reduce the scope of the exemption to commercial carrier transactions—something which Congress never wrote into the statute; which would be most difficult to justify, for reasons already developed, as a matter of legislative policy; and which he cannot add to the Code as a judge, however sure he may be that he would have done so had he drafted this tax legislation.

Indeed, the sensitiveness to revenue needs instilled in this judge by his experience with revenue legislation in recent times misleads him as to the Congressional viewpoint on Section 22(b)(5). Congress made it plain that it was not in a penurious mood in 1919 when it first enacted the provision which later became Section 22(b)(5).[43] On the contrary, prompted by the sudden end of World War I, Congress was actually trying to effect a *substantial reduction* of revenues. As stated by the Senate Finance Committee:

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[43] Section 22(b)(5) of the Internal Revenue Code of 1939 is traceable to Section 213(b)(6) of the Revenue Act of 1918. The pertinent language remained unchanged during the period from the date of its initial enactment to the taxable year here involved.

"The task of financing the operations of a great war gave way to the task of financing the Government through a period of reconstruction and demobilization * * *. The cessation of the war, therefore, brought with it not only the opportunity but the necessity of *reducing the large tax budget* which the House had voted." S. R. 617, 65th Cong., 3d Sess. 1-2 (1919). (Italics added.)

Moreover, the possibility, remote as it may be, that Congress had in contemplation an ascertained amount of exempt income when enacting the statute could hardly affect the scope of the exemption granted. It would be an odd principle of construction which would narrow the scope of "insurance" progressively as the total of insurance proceeds annually received by the taxpaying public increases. Indeed, it is far more likely that Congress, recognizing the social desirability of accident and health insurance, including the establishment of plans of the type at issue here, hoped for the very expansion of such insurance which has in fact occurred, regardless of any revenue loss involved. Moreover, it was always open to Congress to call a halt when it felt the exemption had outgrown the revenue structure and needs; and this was done in 1954 when the exemption was limited to a stated weekly sum —without, however, discriminating between commercially insured and privately insured plans (I. R. C. 1954, Section 105).

In the seventh paragraph of its opinion the court, having offered nothing beyond its own statements to justify its interpretation of the statute, resorted to what the term "insurance" would mean to the "average person". Is it to be assumed that Congress had in mind the "average person" *familiar with insurance*, or the "average person" *not* familiar with it? Surely the former, if any. We submit that one need know very little of

the subject to realize that a formal disability benefit plan, such as is here involved, is an insurance arrangement.

Finally, the court in evident desperation urges that the term "through insurance" in the statute must be given *some* meaning, which would not be the case if *all* compensation for sickness were exempt. With this we agree, but we do not urge that *all* compensation for sickness is exempt. We urge only that where all the fundamentals of insurance in the legal sense are present, the exemption should not be arbitrarily granted in one case and taken away in another merely to narrow—by "judicial fiat"—the scope of the exemption.

Doubtless the line at which wage continuations will be taxed under the statute must ultimately be drawn, but not necessarily in this case where the insurance elements are so clear. Mere voluntary wage continuations, determined at the moment, clearly would not qualify for the "insurance" exemption. Those employment arrangements which simply contemplate in advance that an employee will not be "docked" for absence due to illness up to a specified number of days are more difficult. Such arrangements may be little different from other paid "annual leave"—whether for military encampment, for vacation, or as "sick" leave. When the parties deal in terms of an arbitrary allowance of "leave" that will be available for various purposes without loss of pay, perhaps they do not deal in terms of a risk of loss and indemnification therefor; and may not create an insurance relationship. But this possibility presents no problem here, where the whole purpose and function of the arrangement are born of a desire that the employer assume, on specific terms, what the parties conceived of as a risk of loss capable of protection by the device of insurance.

There is nothing further in the opinion except its disagreement with the *Epmeier* case. We believe that we

have treated every point upon which the court relied.[44] When added together, they sum up to very little. The logic is obscure, and in part based on serious misconception of fact. "Boot-strapping" is visible. The total absence of the *most pertinent inquiry of all*—the meaning of the term "insurance" as developed in the law—is painfully obvious. Heavy reliance on considerations of revenue loss as an ill-defined interpretative aid, as well as on such a feeble crutch as the grasp of language by the hypothetical "average person", is a warning signal that here is a court having trouble justifying a preconceived result. This is the surest sign that the result, itself, is wrong, for if it cannot be better justified, it should not prevail.

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[44] The court apparently intended its final comment to the effect that the insurance must be "bought and paid for by the payment of premiums consciously and knowingly made for 'health insurance'" as a repetition, not a further argument. In any event it was the express policy of the Company to acquaint new employees promptly with the terms of the plan (R. 61), and the employees surely consciously and knowingly rendered their services in reliance upon the promises contained in the plan. (That premiums for insurance may consist of a form of consideration other than cash is well established. See, *e.g.*, *Ollendorf Watch Co. Inc.* v. *Pink*, 279 N. Y. 32, 17 N. E. 2d 676 (1938).) It is common knowledge that fringe benefits of the type provided by the plan are an extremely important factor in attracting and retaining personnel. Indeed, employees are sufficiently conscious of the value of such benefits to make them frequently a principal subject of employee-employer bargaining (see Accident and Sickness Insurance 10, 12 (McCahan ed. 1954)) and, surely, it cannot be necessary that in order to qualify as health insurance the mental image evoked by reference to sickness disability protection must appear in the employee's mind as the precise and technical term "health insurance."

CONCLUSION

On the basis of the foregoing, it is urged that the decision of the Court of Appeals be reversed.

Respectfully submitted,

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APPENDIX A.

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